

# ABS: Listings Due Diligence Guidelines

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*With effect from 13 May 2016*

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## The Association of Banks in Singapore (“ABS”): Listings Due Diligence Guidelines

*These Due Diligence Guidelines should be read as being applicable, with appropriate modifications, to an issue manager or, as the case may be, a sponsor advising on (i) an offer of securities by a business trust or a real estate investment trust seeking a listing on the SGX-ST (as defined below) Main Board, (ii) an offer of securities by a corporation seeking a listing on Catalist, (iii) a listing by way of an introduction, and/or (iv) a reverse takeover.*

### INTRODUCTION TO THE DUE DILIGENCE GUIDELINES

#### 1. REGULATORY FRAMEWORK

##### 1.1 Securities and Futures Act

One of the key objectives of the Securities and Futures Act, Cap. 289 (“SFA”) is to promote adequate, accurate and timely disclosures to enable investors to make informed investment decisions. This is one of the fundamental pillars of a disclosure-based regulatory regime.

Towards this end, in the case of an offer of securities by a corporation, Section 240 of the SFA requires an offer of securities to be made in or accompanied by a registered prospectus. Section 243 stipulates that a prospectus must contain all the information that a person and his professional advisers would reasonably need to make an informed assessment of the securities being offered as well as other information prescribed by the Monetary Authority of Singapore (“MAS”) in the Securities and Futures (Offers of Investments) (Shares and Debentures) Regulations 2005 (“SFR”).

Currently, Sections 253 and 254 of the SFA impose criminal and civil liabilities respectively for any false or misleading statement in or omission of material information from a prospectus, on the following persons:

- (a) the person making the offer and a director or proposed director of such person;
- (b) the issuer and a director or proposed director of the issuer;
- (c) an issue manager;
- (d) an underwriter (but not a sub-underwriter);
- (e) a person who has consented to the inclusion of a statement in the prospectus as having been made by him or which is based on a statement made by him; and
- (f) any other person who made a false or misleading statement or omitted to state required information in the prospectus.

Section 255 of the SFA (if available) provides a due diligence defence against prospectus liability if a person proves that he has made all reasonable inquiries in the circumstances and has reasonable grounds to believe that there was no false or misleading statement in or material omission from the prospectus. The provision places the onus on the issuer and its advisers to ensure adequate and accurate disclosures in the prospectus. In addition, a person will not be held liable if he proves that he has placed reasonable reliance on information given to him by an

unconnected third party.

## 1.2 Listing Manual of the Singapore Exchange Securities Trading Limited (“SGX-ST”)

### Listings on the SGX-ST Main Board

Under the SGX-ST Main Board Listing Manual, Listing Rule 111 requires an issuer to appoint an issue manager to sponsor the listing. Listing Rule 114 states as an overriding principle that directors and executive officers of the issuer are responsible for the accuracy of the information submitted to the SGX-ST. Listing Rule 114 goes on to provide two further principles:

- (a) that the issue manager must exercise due care and diligence in ensuring the completeness and accuracy of the information contained in an application, and
- (b) that the issue manager must ensure that the SGX-ST is informed of all matters which should be brought to its attention.

In the case of a listing on the SGX-ST Main Board, the issue manager must be satisfied that the issuer is suitable for listing. While the issue manager will exercise its own judgment on the nature and extent of due diligence work needed, the SGX-ST would expect it to have knowledge of all relevant facts and circumstances concerning the issuer’s ability to meet the admission requirements, whether the issuer’s directors appreciate their responsibilities, and further whether the directors will see that the issuer complies with its ongoing obligations under the listing rules. In this regard, the issue manager should take note of the confirmations that it has to provide to the SGX-ST, pursuant to Listing Rule 246(4)(a) of the SGX-ST Main Board Listing Manual as well as the declarations that it has to make pursuant to the Listing Admissions Pack.

Practice Note 2.1 of the SGX-ST Main Board Listing Rules articulates the SGX-ST’s expectation regarding an issue manager’s due diligence. It also encourages issue managers to continually review their due diligence procedures to see how such procedures might be refined or improved.

### Listings on Catalist

Under the SGX-ST Listing Manual Section B: Rules of Catalist (“Catalist Manual”), Listing Rule 109 requires an issuer to appoint a full sponsor to be eligible for listing on Catalist. Listing Rule 112 states as an overriding principle that directors and proposed directors of the issuer are responsible for the accuracy of the information submitted to the SGX-ST. Listing Rule 112 goes on to provide two further principles:

- (a) that the sponsor shall exercise due care and diligence in respect of all information that is submitted through it; and
- (b) that the SGX-ST must be kept informed of all matters which should be brought to its attention.

In the case of a listing on Catalist, the sponsor must be satisfied that the issuer is suitable for listing. While the sponsor will exercise its own judgment on the nature and extent of due

diligence work needed, the SGX-ST would expect it to have knowledge of all relevant facts and circumstances concerning the issuer's ability to meet the admission requirements, whether the issuer's directors appreciate their responsibilities, and further whether the directors will see that the issuer complies with its ongoing obligations under the listing rules.

The sponsor should note that, pursuant to the listing confirmation for initial public offerings under Appendix 4B of the Catalist Manual, it is required to confirm that it has complied with these Due Diligence Guidelines (or such other satisfactory and no less strict due diligence guidelines or processes).

Rule 225 and Practice Notes 2B and 4A of the Catalist Manual set out the SGX-ST's expectations regarding a sponsor's assessment of an issuer's suitability and its conduct of due diligence.

In the case of a reverse takeover, the sponsor should note that, pursuant to the listing confirmation for reverse takeovers under Appendix 10A of the Catalist Manual, it is also required to confirm that it has complied with these Due Diligence Guidelines (or such other satisfactory and no less strict due diligence guidelines or processes). Rule 225 and Practice Notes 2B and 4A of the Catalist Manual also apply to reverse takeovers.

### **1.3 Status of the Due Diligence Guidelines**

The Due Diligence Guidelines do not have the force of law nor are they otherwise legally binding on members of ABS; they are recommended by ABS as guidance on due diligence procedures in the context of initial public offerings in Singapore. They may not be applicable in their entirety to secondary or other offerings in Singapore.

### **1.4 The Importance of Effective Due Diligence**

Due diligence plays an important role from the onset when the issue manager<sup>1</sup> evaluates the listing eligibility of an issuer through to the submission of the listing application to the SGX-ST as well as the lodgement with and registration by the MAS of the prospectus for a Main Board listing, or in the case of a Catalist listing, the lodgement with and registration by the SGX-ST of the offer document.

As the prospectus<sup>1</sup> in the context of an initial public offering ("IPO") is the principal document upon which the SGX-ST would assess an issuer's eligibility for listing as well as the document on which public investors would base their investment decision, it behoves the issue manager, with the assistance of other advisers and experts (where necessary), to undertake a reasonably extensive process of checking and verifying that the contents of the prospectus do not contain any false or misleading statement or omit material information prior to its submission to the SGX-ST and its lodgement with the MAS, or SGX-ST, as the case may be. An effective due diligence process is therefore essential, particularly if the issue manager or any other relevant

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<sup>1</sup> For the purposes of these Due Diligence Guidelines, unless the context otherwise requires, all references to "issue manager" shall include a sponsor (as referred to in the Catalist Manual) and all references to "prospectus" shall include an offer document (as referred to in the Catalist Manual), an introductory document or, as the case may be, a shareholders' circular.

party wishes to rely on the due diligence defence under Section 255 of the SFA (if available) when the need arises. An effective due diligence process would also help issue managers to identify issues and concerns that must be addressed and, as appropriate, highlighted to the MAS and/or the SGX-ST.

## **1.5 The Scope and Extent of Due Diligence**

An issue manager must exercise its own judgment in the relevant context and circumstances as to what investigations or steps are necessary to satisfy the general obligations imposed on it by the regulatory framework in Singapore. Issue managers should ensure that all their officers and/or registered professionals in the case of Catalist listings, are familiar with the responsibilities and liabilities of issue managers, or sponsors, as the case may be, under the prevailing regulatory framework in Singapore. Appropriate arrangements should be in place to ensure that junior officers who are involved in the due diligence process are given the appropriate level of supervision by senior officers.

The scope and extent of the appropriate due diligence by issue managers will vary between transactions and may be different from the Recommended Procedures described below, not all of which may be appropriate or applicable. The issue manager should exercise its judgement, appropriate to the context and circumstances, to determine what investigations or steps are appropriate or applicable in the case of a particular issuer.

An issue manager should not expect that doing no more than completing the steps set out in these Due Diligence Guidelines will satisfy its due diligence responsibilities under the regulatory framework in Singapore (although it would be a relevant factor in that determination). By the same token, these Due Diligence Guidelines do not intend to set forth the minimum due diligence steps that must be followed, as what is “reasonable” in each case is likely to be different. Issue managers who do less than the steps set out in the Due Diligence Guidelines are not to be taken as having automatically fallen short of the standards of due diligence required of them. However, such deviation should be on the basis of approaches taken by the issue manager that are reasonable or appropriate as determined by the issue manager after considering all relevant factors. Conversely, issue managers who do merely or more than these steps are not to be taken as having automatically satisfied the standards of due diligence required of them.

## **1.6 Approach Adopted by the Due Diligence Guidelines**

ABS recognises that it is difficult to provide a precise definition of due diligence, particularly, in the absence of clear judicial determination and guidance in Singapore. The Due Diligence Guidelines thus seek to give guidance on the broad framework and principles which issue managers should take into consideration when conducting their due diligence. It also aims to provide illustrative guidance on the procedures which could form a frame of reference for what could be reasonable in the circumstances when applicable. In particular, for offerings involving international distributions, issue managers (and underwriters) will have regard to global market practice and standards, as well as considerations under applicable securities laws. However,

issue managers should always be mindful that a reasonable inquiry might dictate that other inquiries should be undertaken with respect to any aspect of due diligence, according to the circumstances of any given case (including for the purposes of addressing any issues or concerns raised or discovered in the process). Issue managers should not use these Due Diligence Guidelines as a standardised checklist without due and reasonable regard to the context.

The Due Diligence Guidelines are structured in two inter-related sections:

- **General Principles** – this section sets out the broad principles on which a due diligence process should be conducted. The Due Diligence Guidelines identify general principles covering the following four areas:
  - (1) A structured and documented process;
  - (2) Checks and verifications;
  - (3) Overall control of the due diligence process; and
  - (4) The appointment of and reliance on advisers and experts.

In determining the scope and extent of the due diligence to be performed in the context of each offering, an issue manager should take into consideration factors such as the type of issuer or person who is the subject of the due diligence, the nature of the securities, the nature of the industry and business and the jurisdiction(s) in which the operations of the issuer is (are) based.

- **Recommended Procedures** – this section sets out the inquiries which issue managers would normally carry out in a typical IPO (being specific inquiries covering three broad aspects, namely, the management, directors and controlling shareholders of the issuer, the business of the issuer and the expert sections of the prospectus). Issue managers should note that completing the Recommended Procedures by itself may not be sufficient to meet the requirements of the General Principles. In the course of carrying out such inquiries, issue managers must consider carefully whether other inquiries should be made to ensure accurate and full disclosure in the prospectus.

In addition to the guidance provided herein, ABS may issue practice notes from time to time to address issues and concerns which are of interest to the corporate finance industry as a whole.

## 1.7 Underwriters' Responsibility

Although these Due Diligence Guidelines address the due diligence process to be conducted by an issue manager to a listing, the underwriters (other than sub-underwriters) should take cognisance of the fact that they are, in the case of an offer of securities by a corporation, under Sections 253 and 254 of the SFA, amongst the categories of persons regarded as persons having the responsibility to ensure that Section 243 of the SFA has been duly complied with. Persons proposing to act as underwriters to an IPO should therefore implement adequate measures that are reasonable in the circumstances to ensure that they are able to rely on the due diligence defence (if available) against prospectus liability and, in doing so, should have regard to these

Due Diligence Guidelines. Such measures could include (without limit) a review and examination of the due diligence and other reports prepared by the relevant professional advisers and a review of and appropriate follow-up on the due diligence findings of the issue manager.

## 2. SECTION I: REASONABLE DUE DILIGENCE – GENERAL PRINCIPLES

Every issue manager in the context of an IPO is responsible for carrying out reasonable due diligence in the course of the preparation of the prospectus for submission to the SGX-ST as well as for the lodgement and registration with the MAS for a Main Board listing, or in the case of a Catalist listing, the lodgement and registration with the SGX-ST of the offer document. Our objective is to provide guidance for the conduct on what ABS believes is to be regarded as reasonable due diligence which should, in the context of an IPO, take into account the level of skills and experience expected of a competent issue manager. An issue manager should not base its determination of the scope and extent of due diligence (including the appointment of experts) on cost-benefit analysis alone. As a matter of practice, the scope and extent of a due diligence review by an issue manager should generally include obtaining sufficient information to enable reasonable conclusions to be drawn on all matters contained within the prospectus. Where the issue manager becomes aware of information which may indicate potential issues and concerns in the context of the IPO, the scope of due diligence should be varied to ensure that these issues and concerns are properly addressed.

The issue manager should complete all reasonable due diligence on the issuer prior to submission of Section (A) of the Listing Admissions Pack and submission of the draft prospectus to the SGX-ST, except for matters that by their nature can only be dealt with at a later date. Whilst due diligence may continue until the prospectus has been registered by the MAS, the substantive part should be completed prior to submission to the SGX-ST.

### 2.1 Principles:

**2.1.1 Structured and documented process:** The due diligence process should be properly structured and documented.

#### Notes:

- (a) At the outset, the issue manager (with the assistance of the legal advisers, if necessary) should brief, or arrange for the issuer's legal advisers to brief, the issuer, its directors and management and vendor(s) (if any) on their responsibilities and liabilities in connection with the IPO, including but not limited to those set out under the SFA and its related regulations as well as the listing rules of the SGX-ST. The issue manager should explain or arrange for the legal advisers to explain the due diligence process intended to be carried out, with particular emphasis on the need for the issuer to extend its full cooperation and for independence in the checks and verification.

- (b) The issue manager should exercise its judgment, appropriate to the context and circumstances, to determine what investigations or steps are appropriate or applicable in the case of a particular issuer. The issue manager should consider an appropriate structure for the due diligence procedures and should agree with the advisers involved in the preparation of the prospectus on the scope and extent of the due diligence procedures to be undertaken. In doing so, the issue manager should consider the appropriate length of time for the conduct of reasonable due diligence, taking into account, without limitation, the size of the issuer and its group, the extent of its operations (including the geographical reach of its business and operations and whether these are located in emerging or developing markets), the complexity of the group (as to its structure and business and whether the issuer is in a specialised or restricted industry), the need for restructuring pre-IPO and the examination of interested person transactions and potential conflicts of interest. The issue manager should work closely with the issuer and consult with the advisers to the IPO (where necessary) as regards the scope and extent of the due diligence process (including in the case of any significant change to any understanding reached initially as to the scope and process). These Due Diligence Guidelines do not prescribe any form or structure of due diligence process.
- (c) The issue manager should put in place and observe an appropriate document retention policy under which significant due diligence checks and verifications will be documented. In determining such policy, the issue manager should take into account both the objectives of establishing a due diligence defence (if available), as well as satisfying its obligation as a licensed/authorised entity. Information set out in the prospectus must be verified with appropriate sign-offs by the parties responsible for the disclosures. The verification of the prospectus and the preparation of the verification notes recording the appropriate confirmations and sign-offs by the parties responsible for the disclosures may be undertaken by the legal advisers.

Key correspondences such as documents submitted to the SGX-ST and/or lodged with the MAS, as well as any correspondence between the issue manager and these agencies should also be kept so that there is a proper trail of work.

- (d) It remains the sole responsibility of the issuer, its directors and management as well as the vendor(s) (if any) to participate and cooperate in the due diligence process and to respond fully and properly to enquiries made by various parties involved in the preparation of the prospectus.

**2.1.2 Checks and verifications:** The issue manager should (with the assistance of the professional advisers) review and verify material information or representations made by the issuer, its directors, management and/or the vendor(s) (if any).

Notes:

- (a) In conducting due diligence, it may not be appropriate for an issue manager to accept at face value the accuracy and completeness of all statements and representations made, or other information given, by the issuer, its directors, management and/or the vendor(s) (if any) (as well as their respective advisers). To the extent reasonable and where appropriate, the issue manager should carry out, or request advisers to carry out, checks and verifications on material information or representations, and where reasonably appropriate to do so, require such checks and verifications to be carried out by additional independent advisers, investigators and/or experts.
- (b) The issue manager should consider carrying out checks and verifications through interviews (such as interviews with directors and management of the issuer, key employees of the issuer and its principal subsidiaries, internal and external auditors of the issuer and its principal subsidiaries as well as key customers, suppliers and distributors) that would enable the issue manager to make an independent assessment of the matters in respect of which such interviews are conducted. Other independent checks would include, where appropriate, on-site visits and background independent checks on the issuer, its group of companies, directors, management and controlling shareholders.

**2.1.3 Overall Control of the Due Diligence Process:** While the issuer, the directors of the issuer, the vendor(s) (if any), and various other relevant attributed parties, remain responsible for the accuracy of information contained in the prospectus, the issue manager should be closely involved in, and take responsibility for, a due diligence process that is considered reasonable and appropriate in the context of the particular offering. The issue manager may consult other professional advisers as to the appropriate scope of the due diligence process. The issue manager's role is to ensure proper dissemination of information among the parties involved (where relevant), coordinate and ensure the performance of reasonable inquiries, and to evaluate as whether the inquiries are reasonable in the circumstances, and to ensure that, if required, other enquiries and investigations are made.

Notes:

- (a) While the issue manager is entitled to delegate certain aspects of the due diligence to other advisers and experts involved in the preparation of the prospectus, it must continue to be closely involved in and take overall control and responsibility for the due diligence process.
- (b) The issue manager should ensure that all material information and findings are disseminated to the relevant parties involved in the due diligence in order that any conclusion arrived at by an adviser is made as far as possible against other

relevant background and information.

**2.1.4 Appointment of and Reliance on Advisers and Experts:** The issue manager should advise the issuer on the choice of appropriately qualified and experienced advisers (including but not limited to legal advisers) and experts (including but not limited to valuers and industry experts) to whom any aspect of the due diligence would be delegated. When the issue manager seeks to rely on the advisers and/or experts in respect of areas beyond its expertise, the issue manager (together with the issuer, its directors and management) should satisfy itself that such reliance is reasonable in the circumstances.

Notes:

- (a) The issue manager should, as far as practicable, be involved in the appointment and selection of advisers and experts. Where such advisers or experts have already been engaged prior to the issue manager's involvement, the issue manager should nonetheless consider the suitability of those advisers and experts and advise the issuer accordingly.
- (b) The issue manager should be satisfied that the adviser or expert is suitably qualified and experienced and has the capability to perform the terms of reference for which it is to be engaged. The issue manager should take into consideration the track record and specific experience (including prior experience in listings) of the relevant adviser or expert when considering its suitability. In the case of property valuers, the issue manager should take into consideration whether the valuers are internationally reputable valuers who have the necessary experience and track record to provide impartial and robust valuations. In the case of foreign legal advisers, the issue manager should note that where a foreign legal adviser is not ranked by Chambers & Partners, the issue manager may be required by the SGX-ST to demonstrate that it has conducted the necessary assessment to ascertain the suitability of appointment of such foreign legal adviser.
- (c) The issue manager should consider the independence of the adviser or expert. The issue manager should check with the expert that it does not have any interest referred to in paragraph 6 of Part VIII, Fifth Schedule to the SFR. Where necessary, the issue manager should obtain written confirmation from the expert to that effect. Where the expert has material interests (direct or indirect) in connection with any transactions with the issuer outside the scope of its appointment for the listing, the issue manager should discuss with the expert and the issuer in order to assess (to the extent a reasonable non-expert could make such an assessment) whether the same would affect the independence and objectivity of the expert.
- (d) The issue manager should review and discuss the terms of reference of experts with the relevant expert from the outset and be satisfied that such terms of

reference are appropriate (to the extent that a reasonable non-expert could make such an assessment) and to monitor the adherence thereto.

- (e) The issue manager should consider whether the scope of work to be undertaken by the expert and the resources to be applied by the expert to the engagement is appropriate to achieve the objective of the expert's engagement (to the extent a reasonable non-expert could make such an assessment).

### 3. SECTION II: RECOMMENDED PROCEDURES

These Recommended Procedures cover three broad aspects of due diligence in the context of an IPO, namely:

1. Management, Directors and Controlling Shareholders of the Issuer;
2. Business of the Issuer<sup>2</sup>; and
3. Expert sections<sup>3</sup> of the prospectus.

#### 3.1 Management, Directors and Controlling Shareholders

In respect of the existing and proposed Directors and the Executive Officers, the issue manager should carry out a review of their experience and expertise in managing the business of the Issuer, industry experience and their educational and professional qualifications. In respect of the chief financial officer, the issue manager should consider if he has the relevant experience and qualifications, whether he is able to exercise and fulfill his responsibilities taking into account relevant factors and whether he is related to the chairman, the chief executive officer, the Executive Officers and/or the Controlling Shareholders. The issue manager should also assess the character and integrity of the Directors, the Executive Officers and the Controlling Shareholders (if an individual and, if a corporate shareholder, the management of such corporate shareholder). In making this assessment, the issue manager should consider whether there has been any event that would have a bearing on their character and integrity (including any non-compliance with laws and regulations). The issue manager should also consider the suitability of each independent director taking into account relevant experience, industry knowledge, professional expertise and other relevant factors.

As part of the review, the issue manager should include the following:

- *Particulars of Directors and Executive Officers.* Obtain declaration forms and curriculum vitae of the Directors, Executive Officers and Controlling Shareholders (as defined in the listing rules of the SGX-ST). The declaration forms and curriculum vitae should set out their material particulars (including their nationalities,

<sup>2</sup> The term, "Issuer", as used in this section shall include, where appropriate, the Issuer's subsidiaries and associated companies which are part of the listing group.

<sup>3</sup> Any disclosure/write-up in the prospectus that is purported to be made on the authority of an expert or purported to be a copy of or an extract from a report, opinion or statement of an expert. For instance, the audited financial statements and valuation reports.

citizenships, former names and aliases) and their directorships held at present and in the 5 years prior to the registration of the prospectus with the MAS. Their past experience and occupation/vocations should also be included.

Educational and professional qualifications which are material to the business of the Issuer and the job scope of the Directors and Executive Officers should be confirmed against appropriate source documents.

- *Experience and Expertise, and Character and Integrity of Directors and Executive Officers.* Review the work experience and employment history of the Directors and Executive Officers and, where deemed necessary, interviews with such Directors and Executive Officers should be conducted to ascertain relevant experience and expertise. The issue manager should also ensure that the Directors and the Executive Officers are properly briefed on the declaration required from them in respect of their involvement in matters set out in Part VII, paragraph 8 of the Fifth Schedule to the SFR.
- *Independent Directors.* Interviews should also be conducted with the independent directors to assess their suitability, taking into account relevant experience, industry knowledge, professional expertise and other relevant factors such as whether they have any connection to the chief executive officer / 10% shareholder / Issuer e.g. whether any fees and payments have been made, how they had been recommended to the Issuer and the number of independent directorships in other listed companies. In assessing the suitability of the independent directors, the issue manager should take note of the guidance notes on board composition and balance in the Code of Corporate Governance 2012, in particular guideline 2.1 of the Code of Corporate Governance 2012, as well as Listing Rule 210(5)(c).
- *Background Searches.* Public searches (such as personal profile searches at the Accounting and Corporate Regulatory Authority of Singapore or other appropriate agencies, searches for civil and criminal actions and judgments and bankruptcy searches), if available and practicable, should be made. Other database searches (such as those available on Bloomberg or Reuters) should also be conducted, where reasonably appropriate.

Reference checking through parties unrelated to the Issuer, the Directors and the Executive Officers should be carried out where reasonably appropriate. Such checks would include, where reasonably appropriate, checks with affiliates or network partners of the issue manager who have presence in jurisdictions in which the Issuer has operations. Interviews with business associates, customers and suppliers of the Issuer should also be considered.

- *Directors' Training.* For Issuers seeking listing on the SGX-ST, the issue manager shall arrange for all Directors to undergo appropriate training which may include for instance, a briefing by legal advisers on the roles and responsibilities of directors of a company listed on the SGX-ST including the Code of Corporate Governance 2012. In this regard, the issue manager should note that for Main Board listings, Listing Rule 246(4)(e) requires them to provide a confirmation to the SGX-ST that “the directors of the applicant have been informed of their obligations under the listing rules as well as the relevant Singapore laws and regulations.”
- *Checks on legal representatives.* Where appropriate, checks to be performed, with the assistance of legal advisers, on legal representatives of the Issuer (or persons of equivalent authority) relating to their identity, powers and responsibilities, risks relating to their appointment, processes and procedures put in place to mitigate the risks relating to such appointment.
- *Recent resignation or change of Management, Directors and Controlling Shareholders.* Consider whether there are any indications that Management, Directors and Controlling Shareholders who have recently resigned or, as the case may be, ceased to be such persons have done so for reasons that raise questions about the Issuer or about the conduct or attitudes of remaining Management, Directors and Controlling Shareholders.

### 3.2 Business of the Issuer

Based on reasonable due diligence, the issue manager should achieve a thorough understanding of the Issuer and its business, including recent major developments relating to it, and gain an understanding of the industry it operates in. The issue manager should, with the assistance of other advisers (including but not limited to the reporting accountants and legal advisers), carry out reasonable checks and make enquiries as are reasonable in the circumstances to satisfy itself that the information contained in the prospectus (subject to reasonable reliance on the experts in respect of the expert sections)<sup>4</sup> is true in all material respects and does not omit any material fact, the omission of which would render any statement or opinion set out in the prospectus misleading. The scope of reasonable checks and enquiries should include but should not be limited to the following (where appropriate):

- (a) *Use of proceeds.* Assessing whether the proposed use of the proceeds of the IPO as disclosed in the prospectus are consistent with the Issuer’s future plans, business strategy and objectives.
- (b) *Production facilities, properties and material assets.* On-site visits to material production facilities, properties and material assets (which may include

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<sup>4</sup> See Section 2.1.4, “Appointment of and Reliance on Advisers and Experts”.

inventory and biological assets such as livestock and crops) of the Issuer (whether owned or leased) to carry out a physical inspection and where appropriate, the issue manager should consider whether such inspections should be carried out independently without the presence of the Issuer. Local counsel should be engaged to verify that the title to land and buildings and assets which are of material importance to the business belong to the Issuer and that all key approvals have been obtained to build and operate the material production facilities and/or to hold or operate the assets. In reviewing the material production facilities, properties and material assets of the Issuer, the issue manager should take into consideration the disclosures made with respect to fixed assets in the accounts or financial statements reported on by reporting accountants. In addition, the involvement of independent advisers, investigators or experts, including legal counsels, in such review could be considered, where reasonable and appropriate to do so.

In determining whether a production facility, property or asset is material, the issue manager may consider the following factors:

- whether it represents a material component in the Issuer's balance sheet;
- whether it contributes to a material portion of the Issuer's revenue;
- whether it has any encumbrances that may materially and adversely impact the Issuer's operations;
- whether it has any potential defects that may materially and adversely impact the Issuer's operations, or that may have a material and adverse environmental impact; and
- whether it has a material re-development potential.

Note: Without limiting the generality of the guidance set out in paragraph (b) above, it is not intended that this be an audit. 'Physical inspection' simply means visiting the site of the asset in order to see, in person, that the asset exists, and, to the extent practicable, to see that the same materially meets the description provided to the issue manager.

- (c) *Production method and process and value chain of the industry sector.* The issue manager should understand the production method and the process. The issue manager should also understand the quality control procedures and review the changes to the production capacity for the relevant past financial years. The issue manager should understand the value chain context in which the Issuer operates.
- (d) *Major suppliers and customers.* The issue manager should assess whether the Issuer is materially dependent on any particular supplier or customer or groups of suppliers or customers. The issue manager should take into consideration the

following:

- proportion (by dollar value) of purchases from the Issuer's suppliers to total purchases of the Issuer; and
- proportion (by dollar value) of sales to the Issuer's customers to total sales of the Issuer.

Where there is any such material dependency, the issue manager should also interview such customers and suppliers of the Issuer. The issue manager should assess whether the Directors, Executive Officers, Controlling Shareholders and their associates have any interest and/or are involved in the management of these parties. The issue manager should review the manner of executing orders for sales and purchases (supplies), such as whether they are done through long-term contracts and whether the prices are comparable to prices of the sales and purchases of the Issuer to and from other parties. The issue manager should also review the Issuer's distribution and marketing network and plans. The issue manager should consider interviews with key distributors.

- (e) *Material contracts with customers and suppliers and material agreements.* The issue manager should ascertain whether there are any material contracts between customers, suppliers and the Issuer by asking for and reviewing the business aspects of all such material customer/supplier contracts entered into by the Issuer. In respect of material customer/supplier contracts which have or would have a material impact on the financial position of the Issuer, the issue manager should consider obtaining opinions from the appropriate legal counsel to confirm that such contracts are legal, binding and enforceable against the parties.

The issue manager should ascertain whether there are any material agreements with clauses (such as entrenchment of Controlling Shareholder(s)/Unitholder(s) or sponsor in the case of a trust) which may result in a material adverse impact on the Issuer's business and if so, to make an assessment of such clauses.

- (f) *Interested person transactions.* The issue manager should take due care to ascertain whether there are, have been or will be interested person transactions between the Issuer and interested persons. Besides relying on the disclosures to be made by the Directors, Executive Officers and Controlling Shareholders in their respective declaration forms, the issue manager should discuss with the reporting accountants their findings with respect to related party transactions, as well as, with the Directors, the Executive Officers and the Controlling Shareholders on the conduct of interested person transactions. The issue manager should also review the basis of pricing and the terms in the interested person transactions to determine whether they are at arm's length. This is particularly important where the interested person transactions are recurrent in nature. In respect of a listing on the SGX-ST, the appointment of an independent

financial adviser to give its opinion on the interested person transactions should be obtained as necessary.

- (g) *Material litigation and other legal proceedings.* Where there is current or threatened material litigation or other legal proceedings involving the Issuer, the issue manager should, together with the relevant advisers, review and ascertain the business and financial implications arising from such material litigation or other legal proceedings. Public searches on civil and criminal actions taken or judgments ordered against the Issuer should be conducted where practicable. Where there is material litigation, the issue manager should obtain a summary of the action and, where possible, a legal opinion on the merit of the Issuer's case from the legal advisers acting for the Issuer in respect of that litigation.

Where there are allegations/complaints against the issuer, Directors, Executive Officers and/or Controlling Shareholders, the issue manager should investigate all such allegations/complaints.

The issue manager should review non-compliance with laws and regulations by the Issuer (whether repeated or not) which may result in a material adverse impact to the Issuer's financials and/or operations, as well as procedures to prevent a repeat of such non-compliance. In addition, the involvement of independent advisers, investigators or experts, including legal counsels, in such review could be considered, where reasonable and appropriate to do so.

The issue manager should also review adverse findings by regulatory authorities arising from the audits or inspections of the Issuer by such authorities.

- (h) *Analysis of business impact of any legislation/regulation.* In respect of any legislation or regulation or proposed legislation or regulation (which are publicly available) and which, in the judgment of the Issuer or the issue manager may materially affect the Issuer's operations, the issue manager should consider, with the assistance of the legal advisers, the implications of such legislation or regulation and carry out an analysis of the business impact of such legislation or regulation (if necessary). Apart from local legislation and regulation, such legislation and regulation may also include those originating from overseas or cross-border jurisdictions. In addition, the issue manager should carry out, with the assistance of legal advisers, due diligence as is necessary to establish whether the Issuer has obtained all key regulatory approvals and licences required for the Issuer to conduct its business activities. Where key regulatory approvals and licences are pending, the involvement of independent advisers, investigators or experts, including legal counsels, in such due diligence could be considered, where reasonable and appropriate to do so.

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- (i) *Analysis of business impact of any economic or political conditions.* In respect of any economic or political conditions (including any international sanctions imposed on the Issuer) which in the judgment of the issue manager may materially affect the Issuer's operations, the issue manager should discuss with the Issuer's Management the business impact of such economic or political conditions.
- (j) *Industry in which the Issuer operates.* The issue manager should review the industry in which the Issuer's business operates or will principally operate including trends, geographical area and competition within that industry segment. Such review may include relevant material such as trade publications, government statistics and industry / research reports or interviews with industry specialists and the involvement of independent advisers, investigators or experts, including industry experts, in such review could be considered, where reasonable and appropriate to do so.
- (k) *Loans, borrowings, guarantees and contingent liabilities.* The issue manager should review the Issuer's loans, borrowings, guarantees, and contingent liabilities as presented in the financial statements of the Issuer and discuss any material changes since the date of the most recent audited financial statements with the Issuer's Management. In addition, the issue manager should review such documents to understand if they contain any conditions which refer to the shareholding interests of any Controlling Shareholder of the Issuer, or place restrictions on any change in control of the Issuer. Where appropriate, an undertaking to notify the Issuer should be obtained from the Controlling Shareholder if he/it is aware of any share pledging arrangements relating to these shares and of any event which may result in a breach of the Issuer's loan provisions. In addition, the issue manager should make an assessment whether the Issuer's operations are substantially funded by bank borrowings or shareholders' loans. If so, the issue manager should ascertain if the Issuer has in place adequate bank facilities or undertakings from substantial shareholders to continue to provide financial support. If the Issuer's operations are substantially funded by shareholders' loans only, the issue manager should ascertain if the Issuer has encountered difficulties in procuring bank loans. To the extent appropriate, the issue manager should enlist the assistance of the reporting accountants and the legal advisers and the involvement of the Issuer's chief financial officer when conducting the review.
- (l) *Research and development activities.* The issue manager should review the research and development activities of the Issuer.
- (m) *Intellectual property rights, propriety interests and licensing arrangements.* The issue manager should ensure that the appropriate public searches (where

available) are made to ascertain the ownership of any material intellectual property rights, propriety interests and/or licensing arrangements. Where any such rights, interests or arrangements are critical to the operations or business of the Issuer, the issue manager should (to the extent practicable) obtain legal confirmation or opinions on the enforceability of such rights, interests or arrangements.

- (n) *Acquisitions and disposals.* The issue manager should review all material acquisitions and disposals of the Issuer (including those that are proposed or planned) during the relevant track record period. In particular, the rationale for and valuation of the acquisitions or disposals, as the case may be, and the corresponding impact on the Issuer's financial performance, should be considered.
- (o) *Credit policy.* The issue manager should review the Issuer's credit policy, including its credit approval process, trade debtors ageing report and policy for provision of doubtful and bad debts. To the extent appropriate, the issue manager should enlist the assistance of the reporting accountants when conducting the review.
- (p) *Labour relations.* The issue manager should review the labour relations of the Issuer including matters such as whether labour disputes have resulted in disruptions to production or services provided by the Issuer, general level of staff turnover and terms of collective agreements entered into with trade unions.
- (q) *Quality Control.* The issue manager should review the Issuer's quality control process and procedures. Certification such as ISO certification and quality assurance certifications should be verified against source documents.
- (r) *Internal Controls.* The issue manager should also discuss with the Directors and Management the steps taken to ensure the adequacy of internal controls, addressing financial, operating and compliance risks of the Issuer group with a view to ensuring compliance with Listing Rule 610(5) of the Listing Manual and Listing Rule 407(4)(b) of the Catalist Manual, as the case may be. The Directors and Management may consider commissioning an internal control audit by a third party professional firm and/or put in place an internal audit function to provide the assurance on the adequacy of internal controls. The sponsor of a Catalist Listing should note that Listing Rule 406(4) of the Catalist Manual requires it to provide a confirmation in Appendix 4B to the SGX-ST that "The Listing Applicant has established adequate procedures, systems and controls (including accounting and management systems) to meet its obligations under the Rules." Where appropriate, the issue manager should consider recommending to the Issuer to appoint an internal control auditor or compliance

adviser. The issue manager should note that the Listing Admissions Pack requires the Issuer to rectify all material internal control weaknesses and to implement solutions before submission of the listing application to the SGX-ST, as well as an auditors' confirmation that (i) the Issuer has adequately addressed all the material internal controls and weaknesses and/or, as the case may be, (ii) the internal control weaknesses are not material and they are satisfied that the Issuer has adequately addressed all the points raised in the management letter relating to the Issuer's internal controls and weaknesses.

- (s) *Service contracts and incentive and benefit programs.* The issue manager should review the key management service contracts for amongst others, whether these contracts include golden parachute payments, provisions that the Issuer will be released from its obligation to make severance payments to directors in the event of a take-over offer of the Issuer, as well as the incentive and benefit programs (both existing and proposed) including any pension or retirement plans, employee welfare benefit plans and share option schemes. If there are golden parachute payments, the issue manager should ensure that such payments are subject to Chapter 9 of the Listing Manual with regards to disclosure and shareholders' approval. The issue manager should in addition, carry out independent due diligence to confirm that the golden parachute payments are in line with market practice and that they do not constitute a poison pill. The appointment of an independent financial adviser to give its opinion on such golden parachute payments should be obtained if necessary.
- (t) *Conflicts of interests.* For an Issuer seeking listing on the SGX-ST, the issue manager should procure suitably qualified experts or advisers (e.g., external legal advisers) to explain to the Issuer, its Directors and Executive Officers what would amount to conflicts of interest or potential conflicts of interests. The importance of resolving any conflicts of interests must be emphasised to the Issuer, its Directors and Executive Officers. The issue manager, together with the other advisers, should determine if any conflicts of interests or potential conflicts of interest arise based on the information and disclosures made available in the course of due diligence. The issue manager should review the steps taken by the Issuer to resolve or mitigate any adverse impact of the conflicts of interests and be satisfied that they are bona fide and that the Issuer complies with Part VII of Chapter 2 and Paragraph 3 of Practice Note 4.1 of the Listing Manual or, as the case may be, Part VIII of Chapter 4 of the Catalyst Manual.
- (u) *Analysis of the financial performance and position.* The issue manager should discuss with the Directors and the Management the financial figures disclosed in the prospectus with a view to preparing a comprehensible management discussion and analysis of the financial figures for disclosure. The issue manager

should consider any findings of the reporting accountants on the consistency of the disclosed figures against the audited financial statements and audit reports and should consider obtaining appropriate comfort letters. The issue manager should also discuss with the reporting accountants their audit process and internal control findings; as well as whether there are any unusual accounting treatments (after taking into consideration relevant factors, including the accounting treatments adopted by other issuers in a similar industry) and in consultation with the reporting accountants, consider if disclosure in the prospectus is necessary.

- (v) *Financial health of the Issuer.* The issue manager should discuss with the Directors and the Management the Issuer's sufficiency of financial resources (including cash deposits) in the light of the Issuer's projection of profits and cashflow for the current and next financial year, and with a view to assessing the Issuer's business vis-à-vis its competitors and its industry as well as the vulnerabilities and sustainability of the Issuer's business. Where practicable, the issue manager should consider the involvement of its sector specialists in the financial health review of the Issuer. The factors that the issue manager should, where appropriate, consider when assessing the Issuer's sufficiency of financial resources include among others, past and completed orders against current order book, industry trends and their impact on demand and supply dynamics and pricing, feedback from major customers, suppliers and management and whether new capacity will change current pricing and cost structures. The issue manager should consider whether the disclosures made with respect to the Issuer's cash deposits and other related disclosures in the accounts or financial statements reported on by reporting accountants are consistent with their observations from their discussions with the Directors and the Management of the Issuer. The issue manager, when reviewing the Issuer's cash deposits, should enquire whether there are any restrictions on remittances of cash from the Issuer's overseas subsidiaries to the relevant holding company, and whether there are any charges or encumbrances on such cash deposits and whether these are consistent with any restrictions and charges that are disclosed in the audited financial statements. The issue manager should also consider, where appropriate, undertaking a review (to the extent a reasonable non-expert could carry out such a review) with the Directors and the Management of the Issuer the board memorandum which sets out the aforesaid projection of profits and cashflow and discuss the assumptions used to ensure that a reasonable basis for the projection of profits and cashflow was provided. The issue manager should further discuss the existing working capital and cashflow position with the Issuer. As a good practice, the issue manager should consider obtaining an appropriate comfort letter from the reporting accountants. The issue manager should also consider whether the financial ratios of the Issuer are in line with industry norms and if not, whether there are any relevant factors that may explain such

deviation.

- (w) *Profitability and sustainability.* The issue manager should consider the profitability of the Issuer and the competitive advantages that will support the sustainability of the business. The issue manager should also review the prospects of the business to assess the viability of the business.

The issue manager should seek to understand the revenue and costs drivers of the business of the Issuer.

- (x) *Taxation.* The issue manager should conduct routine enquiries of the Issuer's Management (including its senior financial officers), external auditors and tax adviser (if any), aiming to identify any material issues which may warrant further enquiries and to ascertain the following:
- whether all material tax liabilities have been identified and addressed by the Issuer;
  - whether taxes due have been paid;
  - whether current and deferred tax payments have been provided for;
  - whether the Issuer's tax position has been adequately disclosed in the prospectus; and
  - whether the amounts of taxable income and revenue/cost declared to relevant tax authorities in the tax filings are consistent with the Issuer's audited financial statements and whether the amounts of taxation paid by the Issuer as disclosed in the prospectus may indicate any irregularities,
- to the extent a reasonable non-expert could carry out such enquiries.

In conducting such enquiries, the issue manager may request for initial documentary information such as:

- latest tax returns and other tax filing documents;
- list of tax open years;
- tax audit or investigation report (if any);
- details of any material disputes with tax authorities; and
- material fines and penalties.

Depending on the overall level of certainty or uncertainty resulting from such enquiries or discussions and the materiality of the tax issues arising, the issue manager should consider appointing or requesting the Issuer to appoint a tax consultant to address any such issues in connection with the listing.

- (y) *Risk Management.* The issue manager should, where appropriate, assess any financial, interest rate or commodities hedging risks, with the inputs of the Issuer and/or the assistance of other relevant advisers, and review the policies to be adopted for the mitigation of such risks.

(z) *Restructuring Exercise.* The issue manager should, together with the relevant advisers (including legal advisers), review the entire restructuring exercise and the steps to be taken in the restructuring (including the obtaining of any key regulatory approvals and/or completion of any key registrations and/or filings with the relevant authorities prior to the completion of the restructuring exercise), and with the assistance of the relevant advisers, ensure that the restructuring exercise does not breach any relevant law.

(aa) *Corporate Structure and Ownership.* The issue manager should, together with the relevant advisers, review non-traditional/complex structures of the Issuer. This is to ensure that the proposed structure is in compliance with the relevant laws and regulations in which the Issuer operates.

The issue manager should assess whether the group structure is unnecessarily complex such that it could raise suspicion on the legitimacy of its activities, for example, if there is any difficulty in determining the organisation or individual that owns and/or controls the Issuer or to obtain access to them. The issue manager should also consider if there are significant subsidiaries or operations in non-home country jurisdictions that do not appear to have any clear commercial purpose.

(bb) *Anti-Money Laundering (“AML”) and Countering Financial Terrorism (“CFT”).* The issue manager should conduct acceptable AML and CFT due diligence and procedures on the activities and operations of the Issuer and its affiliated companies and its directors, officers and employees, including screening against relevant money laundering and terrorism financing information sources, as well as lists and information provided by relevant authorities in Singapore for the purposes of determining if there are any money laundering or terrorism financing risks in relation to the Issuer. The issue manager shall be able and willing to furnish, without delay, at the request of the SGX-ST, any data, documents or information arising from its conduct of such AML and CFT due diligence.

(cc) *Territories involved.* The issue manager should seek to understand if there are any operations in overseas territories and the economic and business environment of such territories. If the overseas territory involved is regarded as a high risk area (for example, where there is political instability, a weak legal framework and/or the existence of a culture of bribery), the issue manager should assess if it will impact the general reputation of the Issuer group.

### 3.3 Expert Sections of the Prospectus

While the issue manager is not expected and would normally not be equipped to ascertain the correctness of the expert sections of the prospectus, in particular, as to whether the conclusions or opinions arrived at by the experts (following their appointment) are correct, the issue manager should be satisfied that when it seeks to rely on such conclusions or opinions, such reliance is reasonable in the circumstances and should have no reasonable grounds to believe that the information in the adviser's and/or expert's opinion/report is untrue, misleading or contains any material omission. Accordingly, the issue manager should take the following measures before agreeing to the inclusion of an expert section in the prospectus:

- (a) The issue manager should review the expert's report or opinion and actively raise queries on any problem areas with the expert where there are indications of inadequacy or unreliability with the expert's opinion/report. In reviewing the expert's report or opinion, the issue manager should also look out for any material discrepancy or inconsistency against the information and disclosures provided to the issue manager by the Issuer or the information obtained, or findings made, by the issue manager in the course of its due diligence. The issue manager should also review the assumptions on which the expert's report or opinion is based, taking into account the issue manager's understanding and knowledge of the Issuer, its business and industry sector, geographical areas/jurisdictions of operations and business plans, and assess (to the extent a reasonable non-expert could make such an assessment) whether the assumptions are fair and reasonable. The issue manager should also review the qualifications made in the expert's report or opinion. The issue manager should discuss with the expert the basis for using such assumptions or making such qualifications (to the extent that a non-expert is able to do so). Should any such assumption or qualification be atypical of those normally found in other experts' report or opinion, the issue manager should satisfy itself that there is a reasonable basis for the same. All material issues and concerns should be adequately addressed, and if appropriate, highlighted to the SGX-ST. Where the expert's opinion or report is qualified, the issue manager should assess (if necessary, in consultation with legal advisers) whether such qualification is required to be clearly disclosed in the prospectus and, if so, ensure its proper disclosure.
- (b) Where the expert has relied on the findings or opinions of another expert, the issue manager should discuss with the expert and the Issuer in order to assess (to the extent a reasonable non-expert could make such an assessment) whether that other expert possesses the requisite qualifications and expertise and that such reliance on another expert is within the realm of applicable standards and practices.

#### 4. APPENDIX: GUIDANCE NOTES

This Appendix sets out, in the form of case studies, some guidelines on a set of appropriate measures that should be considered in certain situations.

The following case studies illustrate the measures that should be undertaken in the context of the General Principles that are set out in Section I of the Due Diligence Guidelines. However, the measures illustrated in the situations below should not be considered exhaustive.

##### 4.1 Director and Management

Company A, incorporated in Country 1, designs and manufactures high-end computer chips. Its main operations are in Country 2.

- Person X, Company A's founder and chairman, changed his name and citizenship in FY2000. Previously a citizen of Country 2, Person X is now a citizen of Country 3. Person X said that anyone who invests US\$500,000 in Country 3 can apply for citizenship.
- Company A has a team of 20 researchers led by Person Y, the chief researcher of Company A.

##### Issues to be addressed:

- How to assess the character and integrity of Person X for the purposes of SGX-ST's Listing Rules?
- What steps should be taken to assess the experience and expertise of Person X and Person Y for the purposes of SGX-ST's Listing Rules?

##### Response:

- *Enquire reasons for the changes in citizenship. The issue manager should consider the reasonableness of Person X's response. Database searches should be conducted on Person X and, where available, public searches on civil and criminal actions and judgments to be made on Person X. Reference checks should also be made. The issue manager should also consider if background independent checks are appropriate based on the facts and findings made known to it or discovered by it.*
- *Experience and expertise to be assessed through interviews, educational qualification and track record. Academic papers written by them as well as their affiliation with universities and research centres (if any) would serve as supporting evidence. Interviews with Person X and Person Y should be conducted by the issue manager.*

#### 4.2 Production Facilities

Company A, incorporated in Country 1, produces widgets using a proprietary technology. There are only 5 manufacturers of widgets in the world, and each uses a different technology.

- Company A has 8 factories (6 in Country 2, 1 in Country 3 and 1 in Singapore).
- Company A's revenue surged 700% from \$17.8 million last year to \$124.6 million this year. The directors explained that this is because output increased after Company A switched to a new technology that it developed in-house.

##### Issues to be addressed:

- How to ascertain that the material production facilities exist and belong to Company A?
- How to verify that Company A has all the necessary key approvals and rights to build and operate the factories?
- How to verify whether Company A's production capacity is consistent with its output?
- How to ascertain the reason for the increase in Company A's production capacity?

##### Response:

- *Perform on-site visits to all material production facilities. During the on-site visits, randomly pick some key employees working on-site and ask appropriate questions.*
- *Engage local counsel to ascertain the ownership of material production facilities. As far as practicable, carry out independent checks.*
- *Engage local counsel to confirm that all necessary key approvals for material production facilities have been obtained and that Company A has the right to build and operate the material factories.*
- *The issue manager needs to understand production method and process so as to assess reasonableness of production capacity (as disclosed) against output. In highly specialised industries (such as power generation industry), the issue manager should consider if it is necessary to obtain an expert's opinion.*

- *Discuss with the reporting accountants on the work done by them/auditors to verify the sales/revenue figures, as well as the increase thereof.*

#### **4.3 Major Suppliers and Customers**

Company A, incorporated in Country 1, produces computer hardware. Its main operations are in Country 2.

- 6 of Company A's customers accounted for 5% or more of its revenue for the last three financial years. Its single largest customer, Company B, accounted for approximately 20% of its revenue for the last three financial years.
- 4 of Company A's suppliers accounted for 5% or more of its cost of sales for the last three financial years. Its single largest supplier, Company C, accounted for approximately 60% of its cost of sales for the last three financial years. The directors commented that Company A has signed a memorandum of understanding with Company C on the supply of parts for the next 2 years at specified prices. The MOU was signed by a sales representative of Company C.

##### Issues to be addressed:

- How to assess whether Company A is dependent on any particular supplier/customer?
- How to ascertain whether there are any material contracts between Company A and its major suppliers/customers and whether such contracts are legally enforceable?

##### Response:

- *In assessing whether Company A is dependent on a particular supplier or customer, the issue manager should take into consideration the profile of that supplier or customer and compare it to those of Company A's other suppliers and customers. For example, if that supplier or customer is the only one with a long-term contract or relationship with Company A, that may be indicative of dependence on that supplier or customer. To the extent possible, the issue manager should interview the major customers and suppliers of Company A and the issue manager should also review the manner of executing orders for sales and purchases (supplies), such as whether they are done through long-term contracts. The issue manager should also review Company A's distribution and marketing network and plans. The issue manager may also conduct database searches (through Bloomberg, Reuters or via internet) for information relating to Company A's customers and suppliers to see if Company B and Company C are cited as their major customers or suppliers (as the case may be).*

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- *Company A should be asked to provide all material contracts relating to supply or purchase agreements entered into with its customers or suppliers.*
- *Local counsel may be engaged to verify the legality, validity and enforceability of contracts which are major to the operations of the Issuer and its group.*

### 4.4 Interested Person Transactions

Company A, incorporated in Country 1, operates primarily in Country 2.

- The directors said that Company A's only current interested person transaction is a lease agreement with its executive chairman, Person X, for the rental of Person X's property in Country 1 as an office. The total rental paid to Person X in the last two years is \$45,900 and \$56,300 respectively.
- The directors disclosed that Company A has dealings with Company AA. Company AA used to be owned by Person X. But Person X sold his entire stake in Company AA to Person Y last year, and so Company AA is no longer an interested person.

#### Issues to be addressed:

- How to ascertain whether Company A has had or will have any material interested person transactions that require disclosure?
- How to verify the terms of the transactions entered by Company A with Person X and Company AA and whether the terms are determined on an arm's length basis?

#### Response:

- *Review the disclosures made in the proforma accounts or financial statements reported on by the reporting accountants and, to the extent necessary, check with the reporting accountants on the same.*
- *To assess whether terms of sale of stake in Company AA is at arm's length, the issue manager should look at the purchase consideration and the basis of arriving at such purchase consideration (i.e. NTA, PE, price to book, etc.). Where there are similar transactions in the market, to compare the terms (if such information is publicly available).*

### 4.5 Conflicts of Interest

- 4.5.1 Company A is a listed company in Country 1 and it is spinning off its subsidiary, Company B for a listing on the SGX-ST. Both Company A and Company B operate in the same industry and may from time to time share common customers and markets. As Company

A and Company B are from the same group, the same group of management is running both companies before Company B's proposed listing.

Issues to be addressed:

- How to regulate and demarcate the operations of Company A and Company B so that the potential conflicts of interests can be resolved?
- How to ensure that the board and management team of both companies are separate and sufficiently independent from each other so that they will act in the interests of the respective companies which they are appointed to?

Response:

- *The issue manager/sponsor should ascertain the main differences and overlaps (if any) between the businesses of Company A and Company B. Based on this, a non-competition undertaking must be obtained from Company A so that it will not compete directly with Company B for the same business. In preparing an appropriate non-competition undertaking, the issue manager/sponsor should consider the following:*
  - *As Company A is a listed company and the proposed listing of Company B may be subject to the approval of shareholders of Company A, the demarcation of business activities and operations between Company A and Company B should not unduly limit the existing activities and operations of Company A;*
  - *For the businesses of Company A which are in direct competition with Company B's operations, how best to demarcate the businesses of Company A and Company B, for example, by customers, products or geographical regions;*
  - *If it is not feasible to clearly demarcate the businesses of Company A and Company B by customers, products or geographical regions, to consider demarcation of the businesses with exceptions, for example, Company A is allowed to sell its products to its existing customers but for purchase orders from any new customers, right of first refusal will be given to Company B; and*
  - *For how long and in what circumstances should the duration of the non-competition undertaking be in place. For instance, the non-competition undertaking should be in place for as long as Company A and its associates hold a controlling stake in Company B subject to a minimum duration to be recommended by the issue manager/sponsor.*
- *The issue manager/sponsor must ensure that Company A and Company B can operate independently. Each company must have separate boards where no director has dual executive role on both boards and key management teams with specific responsibilities. In particular, the board of Company B should have at*

*least a majority of independent directors supported by a well defined internal audit function to ensure adequate checks and balances.*

- *The issue manager/sponsor must ensure that resources for key business functions are not shared between Company A and Company B, for instance, each company should have their own marketing, production, finance and other key business functions as appropriate.*
- *The issue manager/sponsor must assess the necessity of implementing a general mandate for interested person transactions to review the terms of such transactions post-listing. If a general mandate is required, an independent financial adviser should be appointed to provide an opinion on the proposed terms.*

4.5.2 Person X, a Controlling Shareholder of Company A, is a director of a number of companies. The other Controlling Shareholders owned shares in some of these companies. Person X sold his stakes in some of these companies and stepped down from them.

Issues to be addressed:

- How to ascertain whether there are any potential conflicts of interest arising from the sale of Person X's holdings?

Response:

- *The issue manager should obtain a full explanation from Person X on the reason for the sale of his stakes in those companies. The interests and involvement of the other Controlling Shareholders in those companies should be carefully examined. The issue manager should request for details on the businesses and industry in which those companies are involved in. Based on the information obtained, the issue manager should determine if there are any potential conflicts of interests.*
- *Independent checks on the other Controlling Shareholders and those companies should be made.*

**4.6 Analysis of Financial Performance and Position**

Company A, incorporated in Country 1, trades car parts.

- Company A's business extends to countries in Southeast Asia, Central Asia, Africa, Latin America and Europe. The majority of its revenue is derived from Southeast Asia and Central Asia (about 70%). The transactions with Central Asia, Africa and Latin America are mainly on a cash basis.

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- Company A's gross profit surged by 600% from \$8.9 million to \$53.4 million in the latest financial year while revenue went up by around 400% from \$59.3 million to \$213.6 million. The directors explained that the improvement is due to increased pricing for products sold and bulk discounts given by the suppliers.

### Issues to be addressed:

- How to assess risks related to the significant cash transactions, including but not limited to money laundering, fraud and financial misstatement?
- How to verify the accuracy of the revenue and gross profit figures and the explanation for the material fluctuations in revenue and gross profit?

### Response:

- *The issue manager should consider reviewing bank statements and sample transactions, including the terms and nature of the transaction, the size of each trade and the profiles of major customers and conduct interviews with major customers to the extent possible.*
- *Discuss the accounting treatment of revenue and gross profit with the reporting accountants (including work done by them).*
- *The issue manager should interview the major suppliers over the bulk discounts and, to the extent possible, check if such discounts are industry practice.*
- *Where appropriate, the issue manager should engage an independent adviser or investigator to carry out an independent investigation.*

## **4.7 Financial Health of the Issuer**

Company A reported negative cash generated from its operations for the latest financial year ended 31 December 20X1 and half year ended 31 December 20X2. It has committed to purchase a number of properties of which 20% deposit has been paid and the balance is due in December 20X2.

### Issues to be addressed:

- How to ascertain whether Company A has sufficient resources to meet its obligations when they fall due in Dec 20X2?

### Response:

- *The issue manager should benchmark Company A's financial performances against its comparable.*

- *The issue manager should review carefully Company A’s cashflow forecast and projection for the next 2 years as set out in the board memorandum and assess its reasonableness with the assistance of the reporting accountants.*

#### **4.8 Verification of Documents**

Company A made deposits amounting to \$X million and \$Y million as at 31 December 20X2 and 30 June 20X3 for “future share subscriptions” in its associated companies AA and BB.

Issues to be addressed:

- How to verify the validity and existence of such transactions?

Response:

- *The issue manager should review the terms of the “future share subscriptions” as well as the reason for Company A’s commitment to such “future share subscriptions”.*
- *The issue manager should consider asking for bank confirmations or statements to verify the existence of such deposits. The issue manager should consider asking for confirmation from the reporting accountants/auditors that the deposits were reflected accordingly in the financial records of Company A. The issue manager should request Company A’s directors to give more details of the “future share subscriptions” including the timeline for the further investments and the purpose of the additional funds to be injected into the associated companies.*
- *Where appropriate, the issue manager should consider securing an undertaking from Company A’s directors that these deposits will be used only as earmarked.*

#### **4.9 Existing Shareholders and Moratorium**

Company A’s shareholders consist of 2 directors (each holding 30%) and a large number of individuals (each holding less than 5%). Some of these individuals are siblings, relatives and friends of each other and have acquired Company A’s shares less than six months ago.

Issues to be addressed:

- How to ascertain the purpose of these individuals’ involvement in Company A?

Response:

- *The issue manager should request Company A’s directors to provide details on how and why the individuals were approached to subscribe for the shares.*

*Company A's directors should also be briefed on the concert-party implications under the Singapore Code on Takeovers and Mergers. Declarations should also be obtained from Company A's directors that none of these individuals are holding the shares in trust or under the control or influence of Company A's directors. Random selection of some of the individuals for interviews with the issue manager may also be considered.*

- *The issue manager should consider requesting the associates of company A's directors (including their siblings and relatives) to subject their shares to moratorium following listing.*

#### **4.10 Reliance of the Issue Manager on an Expert**

Company A, incorporated in Country 1, manufactures high-end computer chips. Its factory in Country 1 manufactures approximately 85% of its total annual production output.

During the issue manager's factory visit in Country 1, the issue manager interviewed Company A's production supervisor. The issue manager noted that the production supervisor was uncertain of his job scope and the production cycle. Company A's auditor did not disclose this as a weakness or risk area in its report on Company A's internal controls.

##### Issues to consider:

- To what extent can the issue manager rely on the report on Company A's internal controls prepared by the auditor?
- Are there any steps that the issue manager should take before relying on the auditor's internal control report?

##### Response:

- *The issue manager should discuss the internal control report with the auditors and require the auditors to provide a response on the omission. Further checks may be necessary to ensure that the internal control report is in order.*
- *The issue manager should be satisfied with the basis on which the internal control report is prepared. If necessary, the auditors should be required to perform more detailed work to check on the adequacy of the internal controls.*

#### 4.11 **Inconsistency in Financial Disclosure**

The financial year-end for Company A is 31 December 20X1 and the auditors' report on the Company A's audited financial statements for the year ended 31 December 20X1 was issued on 7 March 20X2.

- During the issue manager's interview with Company A's CFO, the issue manager noted that Company A had obtained a bank loan on 27 February 20X2. This was not disclosed in Company A's audited financial statements.
- Upon review of the audited financial statements, the issue manager noted that there were material advances to one of Company A's directors, Mr X. This was not highlighted by the auditors during this first drafting meeting.

##### Issues to consider:

- To what extent can the issue manager rely on Company A's audited annual financial statements prepared by the auditor?
- Are there any steps that the issue manager should take before relying on the auditor's report?

##### Response:

- *The issue manager should review the audited annual financial statements with the auditors and require the auditors to provide a response to the omissions. Further checks may be necessary to ensure that the audited financial statements are in order. If the issue manager remains uncomfortable after the review and explanation, the issue manager should consider engaging an additional set of reporting accountants to carry out a review on the financial figures.*

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