

# PACIFIC STAR DEVELOPMENT LIMITED

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## UPDATE IN RESPECT OF INDEPENDENT REVIEW BY RSM RISK ADVISORY PTE LTD

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The board of directors (the “**Board**”) of Pacific Star Development Limited (the “**Company**” and together with its subsidiaries, the “**Group**”) refers to the Company’s announcements dated 1 August 2019 (the “**1 August 2019 Announcement**”) and 28 August 2019 (the “**28 August 2019 Announcement**”) in relation to the reversal of certain revenue recognised in the Group’s Puteri Cove Residences project (“**PCR**”) relating to the quarterly financial results of the Group for the financial periods ended 31 December 2018 (“**2Q2019**”) and 31 March 2019 (“**3Q2019**”) (the “**Adjustments**”).

*Unless otherwise defined or the context otherwise requires, all terms used herein shall have the same meanings as defined in the 1 August 2019 Announcement and the 28 August 2019 Announcement.*

### **Background of the Adjustments**

The engagement of RSM Risk Advisory Pte Ltd (“**RSM**”), the Company’s Internal Auditors, to conduct an Independent Review on the internal controls relating to the Adjustments (the “**Review**”) to assess the appropriateness of revenue recognized, was initiated by the Audit Committee (the “**AC**”) after being made aware by the incumbent Group Financial Controller (the “**GFC**”) of non-fulfillment of certain Sale and Purchase Agreements (the “**SPAs**”) pertaining to seventeen (17) units in PCR, of which ten (10) units and five (5) units were recognised as sales in 2Q2019 and 3Q2019 respectively whilst two (2) units were recognised as sales in prior years (in 2014 and 2015).

The effect of the Adjustments to the Group’s revenue in 2Q2019 and 3Q2019 amounted to S\$4.67 million and S\$2.5 million respectively and total comprehensive loss for 2Q2019 and 3Q2019 were understated by S\$2.0 million and S\$0.92 million respectively. The impact of the Adjustments had been adjusted in the Company’s unaudited financial statements and dividend announcement for the twelve months ended 30 June 2019 which had been released on 29 August 2019. Please refer to the 28 August 2019 Announcement for further details relating to the Adjustments.

In respect of the above matters, RSM has completed the Review and submitted its report to the AC (the “**Report**”), and the Company wishes to furnish a summary of the findings from the Report to its shareholders.

Shareholders of the Company are advised to exercise caution when dealing in the shares of the Company. Persons who are in doubt as to the action they should take should consult their stockbrokers, bank managers, solicitors, accountants or other professional advisers.

### **1 Summary of Issues**

Based on RSM’s review relating to the seventeen (17) transactions, they have identified six (6) lapses and deficiencies in standard operating procedures (the “**SOPs**”) and transactions, which are summarized below:

**i. Key sales controls not formalised in policy**

From the Review, certain control activities were not spelt out clearly in the sales policies and procedures (the “**Policy**”) as a guide:

- a) Stringent criteria to assess potential buyer aside from obtaining a copy of the buyer’s identification;
- b) Timeline for the sales ambassador/bank financier to follow up with the agent/potential buyer on the status of bank loan application;
- c) The requirement to document and file bank loan application and status updates provided by bank;
- d) Delegation of Authority (the “**DOA**”) required for deposit refunds;
- e) Timeline between the appointment with the buyer and the date of SPA signing;
- f) Policy on deferred payment scheme and fixed return scheme;
- g) Timeline for Johor State Consent application; and
- h) Prohibition to sign SPA with any party that does not represent sales to end-buyer.

**ii. SPAs for five (5) PCR units were signed with individuals who were not property end-buyers**

There were five (5) PCR units for which SPAs were signed with the representatives of one of the marketing agencies for PCR (the “**Marketing Agency**”). Whilst these five (5) PCR units were recognised as revenue with the accompanying SPAs signed, RSM was informed by the Sales and Marketing Director (the “**SMD**”) of PCR that the Marketing Agency had no intention of buying these units and the signing of SPAs were meant as advance commitments by the Marketing Agency to transfer the units ownership to third parties buyers at a later date. As at the date of the Report, third party buyers for these five (5) units have not been secured.

RSM concluded that there is no evidence in the agency agreement signed with the Marketing Agency that requires them to be responsible for purchasing the units should they be unable to source buyers for these units after a specified period of time. Hence, there is no rationale for revenue to be recognised since the Marketing Agency is not the end buyer and the agency agreement with the Marketing Agency does not require them to buy should they be unable to source end buyers.

**iii. SPAs for seven (7) PCR units were signed without adequate due diligence and bank loan financing documentation**

There were seven (7) SPAs which were signed with buyers who wanted to purchase the properties using loan facilities. The revenue for these units was recognised although the due process to obtain supporting documents to verify these buyers’ ability to finance the property had not been complied with.

Loan buyers are required to provide proof of bank loan documents and to submit the deposits before signing the SPAs as stated in the Policy. However, in these seven (7) cases, only the buyers’ identity cards/passports had been obtained. Minimum deposits were not collected and there was no evidence that the loan documentation had been submitted.

**iv. Insufficient due diligence for three (3) cash buyers to support funding ability**

In respect of three (3) SPAs signed by cash buyers, RSM was not able to ascertain whether proper due diligence and the required financial safeguards were taken to recognise these revenue. There was no evidence that documentation to support appropriate due diligence (i.e. personal financial background, pay slips, income tax & provident fund statements and bank statements) were obtained. As such, it was not determinable if the sales team had been satisfied as to the buyers' financial abilities to fund the properties and meet their SPA obligations prior to the recognition of revenue.

**v. Lack of delegation of authority over utilisation of payments to offset outstanding sums from other units**

There had been a request by a buyer, someone related to the director of the former joint venture partner of the Company's subsidiary Pearl Discovery Development Sdn Bhd ("**PDD**"), of one (1) PCR unit to rescind the purchase of that particular unit and to transfer the amount paid in respect of that PCR unit to be applied towards the purchase price of another unit purchased by the first-mentioned buyer's relative (the "**Proposal**").

On 17 October 2018, an email was sighted from the SMD, who had obtained clearance from the Chief Executive Officer (the "**CEO**") relating to the Proposal.

This possible related party transaction and arrangement was not disclosed to the Board or the AC for clearance.<sup>(1)</sup>

There were inadequate guidelines in the policies to address authorisation required for cross funding of units and whether this as a practice would be allowed.

**vi. Reversal of two (2) cash sales due to lack of financing ability to fulfil SPA obligations**

On 15 July 2019 and 17 October 2018, there were two (2) cash unit buyers who made their requests to cancel their units bought in 2014 and 2015 respectively, of which one (1) unit relates to that described in preceding paragraph (v) above.

RSM had noted that there was insufficient due diligence conducted and documented to prove that these cash buyers possessed the ability to fulfill their SPA obligations in 2014/2015. As represented by the SMD, the revocations were due to a lack of sustainable financial solutions by these buyers to fulfill their SPA obligations.

**2 Root Cause Analysis**

RSM had identified the key root causes for the abovementioned lapses and these are summarised below:

**i. Corporate Manual and Policy**

The sales policies and procedures were not reviewed regularly (at least annually), and therefore did not contain the best practices and existing controls required as a guide. The Corporate Manual was documented in 2016 and latest updated version was released in January 2018.

- ii. SPAs for five (5) PCR units were signed with individuals who were not property end-buyers**
- a) The arrangement with the representatives of the Marketing Agency for the five (5) units' SPAs was not representative of the usual sales commission-based arrangement. The Marketing Agency should not have signed SPAs to commit to selling a certain volume of units and those units should not be taken as revenue;
  - b) There should have been proper terms stated in the agency agreement with the Marketing Agency to determine the basis upon which sales are recognised and the recourse in the event of the lack of conclusion of a sale;
  - c) Johor State Consent application has not been obtained;
  - d) No enforcement on the collection of booking deposits; and
  - e) Lack of formal follow up and due diligence to ascertain whether the deposits for the five (5) units should be collected from the Marketing Agency.
- iii. SPAs for seven (7) PCR units were signed without adequate due diligence and bank loan financing documentation**
- a) Lack of detailed written policy and enforcement to ensure adequate due diligence was conducted on the personal financial background of the buyers;
  - b) Lack of detailed written policy and enforcement to ensure Malaysian buyers had obtained evidence of bank loan applications before signing of SPAs;
  - c) Lack of detailed written policy and enforcement to ensure that all loan buyers regardless of nationality provide evidence of bank loan applications; and
  - d) Lack of proper policies and enforcement to ensure that loan documents and supporting information are obtained and retained to support the status of the SPA processing.
- iv. Insufficient due diligence for three (3) cash buyers to support funding ability**
- a) Lack of enforcement of full collection of cash payments in lieu of unit sales prior to processing of SPA; and
  - b) Absence of formal policy to guide risk safeguards for cash-based sales.
- v. Utilisation of payments received to offset outstanding sums from other units**
- a) A lack of clear DOA defining the approvals needed for accepting the revocation of property transactions or any transfers of ownership or payments to other units prior to completion of sale or handover to the buyer; and
  - b) No disclosure of related transactions involving unit buyers and the approvals for any non-standard sales arrangements to the AC, the Board or the Executive Committee (the "EXCO").

**vi. Reversal of two (2) cash sales due to lack of financing ability to fulfil SPA obligations**

- a) Lack of adequate assessment of the financial abilities to make payment for cash sales transacted in 2014/2015; and
- b) The lack of policy guiding the financial safeguards and checks to be made for cash sales.

**3 Recommendations**

From its overall assessment, RSM has made the following recommendations to the Board and Management of the Company:

**(A) Recommendations to the Board and Senior Management of the Company**

- a) Evaluate the findings relating to the seventeen (17) PCR units and determine if the sales need to be adjusted accordingly.
- b) Enhance reporting of sales to ensure that sales are only recognised when SOPs and triggers are clearly met to indicate passing of risk and rewards to end-buyers.
- c) Enhance reporting of sales which are pending and actions taken to confirm/reject the sales.
- d) Enhance sales forecasting process and the impact on cashflows for the PCR project.
- e) Establish a clear code of conduct for the sales team and reiterate the financial gates and milestones that must be fulfilled for sales recognition.
- f) Implement a revised DOA that requires an additional independent approver aside to the CEO for sales on non-standard terms and sales reversals.

**(B) Recommendations in relation to the sales process**

**i. Key sales controls not formalised in policy**

RSM has recommend that management state the following in the sales policies:

- a) Stringent criteria to assess potential buyer other than obtaining a copy of the buyer's identification;
- b) Timeline for the sales ambassadors/salespersons to follow up with the agent/potential buyer on the status of bank loan application;
- c) The requirement to document and file bank loan application and status updates provided by bank;
- d) Delegation of authority required for deposits returns;
- e) Timeline between the appointment with buyer and SPA signing;
- f) Terms and conditions relating to offer of deferred payment scheme and fixed return scheme;
- g) Defined timing for collection of booking fee;

- h) Timeline for collection of Johor State Consent application from buyer;
- i) Prohibit the signing of SPAs with parties that do not represent sales to end-buyer; and
- j) Timeline to collect the stamped and endorsed SPA.

**ii. SPAs for five (5) PCR units were signed with individuals who were not property end-buyers**

RSM recommended that the following can be implemented:

- a) Review agent contractual terms to spell out clearly the obligations of both parties;
- b) Step up rigour of the review on each buyer profile to ascertain validity of the buyer and adequacy of the due diligence process;
- c) The finance team should ensure all billings to buyers are performed timely; and
- d) To state in policy that invalid sales transactions to marketing agents who do not represent sales to end-buyers are prohibited.

**iii. SPAs without adequate due diligence and bank loan financing documentation**

RSM recommended that the following can be implemented:

- a) To formalise in policy that Malaysian buyers must obtain loan approval before signing of SPA<sup>(2)</sup>; and
- b) To formalise in policy that all loan buyers regardless of nationality shall provide evidence that they have applied for bank loans and these loan documents are to be filed and updated with the status of the bank loan application timely.

For all buyers, management should also establish a more stringent due diligence policy to ensure that adequate due diligence is conducted over personal financial background (e.g. by requesting buyer pay slip, income tax & provident fund statement and buyer bank statement).

**iv. Lack of delegation of authority over utilisation of payments to offset outstanding sums from other units**

- a) RSM recommended that the management establish a formal DOA for the approval of non-standard financing arrangements;
- b) The AC and Board should be apprised of possible related party transactions; and
- c) There should be approval sought before proceeding with such transactions.

**v. Reversal of two (2) cash sales due to lack of financing ability to fulfil SPA obligations**

RSM recommended that the management enforce the basis for revocation in the Revocation Forms which must be approved before a revocation can be performed. A timeline on the revocation submission and approval process should also be established.

**vi. Key Matters**

**(i) Duty of care on sales transactions, deposit collection and revenue reversal**

- a) There should have been sufficient and formal due diligence on sales transactions recognised and follow up on outstanding deposits performed. There should have been proper duty of care exercised to assess the basis for the recognition of revenue based on the amount of deposits collected, payment received and the supporting documentation obtained for these sales.
- b) There should also have been further efforts taken to formerly monitor outstanding buyers' payments and escalate collection status and any issues thereon timely.
- c) There should be a robust DOA in place to govern the following:
  - Any changes to the standard sales contract – approval from the Board;
  - Any waiver of deposits – approval from EXCO<sup>(3)</sup> (not just CEO); and
  - Any matters relating to financial oversight – approval from AC.

**(ii) Responsibility and oversight of the Finance function**

- a) The former Group Financial Controller should have been made privy to details of sales and deposit status to enable him to formally review and escalate queries on sales recognition or collection status.
- b) The potential revenue reversal situation should have been highlighted to the AC on a timely basis for approval.
- c) The functions and responsibilities of the Finance Team should be reiterated, including oversight roles for reporting and stewardship of the Group's financial resources.

**Notes:**

- (1) For the avoidance of doubt, the above arrangement does not constitute an interested person transaction for the purpose of Chapter 9 of the Listing Manual Section B: Rules of Catalist of the Singapore Exchange Securities Trading Limited.
- (2) This pertains to Malaysian buyers opting to pay via loans for their purchases. As it is not practical to have the loan applications approved at the point of signing of the SPAs, the amended Policy will require evidence of application of bank loans to further process the duly signed SPA.

- (3) The EXCO was dissolved on 7 June 2019, hence the approving authority for waiver of deposits as spelt out in the amended Policy will be the Board.

**Additional Controls to be effected pursuant to the Recommendations by RSM**

The AC and the Board have reviewed the findings of the Report and have accepted these findings. Moving forward, the Company will implement all of the recommendations provided by RSM and improve all necessary processes and internal controls. Specifically, the Company will:

- (i) Review and Update the Policy to incorporate all the recommendation by RSM, specifically:
- All revenue to be recognised must satisfy the revenue recognition criteria as stated in Singapore Financial Reporting Standards (International) 15 – Revenue From Contract with Customers;
  - To reiterate the signing of SPA is not the sole revenue recognition criteria;
  - Detailed guidance relating to the recognition of revenue relating to buyers opting to pay in cash, via loans or in exchange of services provided to the Group;
  - Unless there are commercial justifications, prohibiting the signing of SPAs with parties that do not represent sales to end-buyer. Provided always that, such SPA can only be recognised as revenue if it satisfy the revenue recognition criteria as stated in Singapore Financial Reporting Standards (International) 15 – Revenue From Contract with Customers; and
  - Cross funding of units has to be in the best interest of the Group and has to be approved by the local finance manager, the Group Financial Controller and the CEO.
- (ii) To review and update the DOA to address, amongst others, the following:
- Deposits returns;
  - Approval of non-standard financing arrangements/sales terms/standard sale contract;
  - Any waiver of deposits from the standard rate as stated in the updated Policy; and
  - Approval of related party transactions.
- (iii) Other matters
- With effect from 18 June 2019, the Executive Chairman has direct oversight of the Group's Finance Function. It has been reiterated to the incumbent GFC and members of the Group's finance team on their oversight roles for reporting and stewardship of the Group's financial resources and the escalation procedures relating to accounting issues to the GFC, the Executive Chairman, and to the AC (if necessary).
  - New monthly reporting for SPAs signed, deposits received, proposed SPA revocation and recommendations of revenue to be recognised to be jointly submitted by local finance manager, the GFC and the CEO ("**New Sales Reporting Format**") for approval by the Executive Chairman.
  - Tabling of the New Sales Reporting Format at the quarterly AC meeting for review and approval.



- Monthly review of Trade Receivables ageing to enhance sales collection and identify potential risk of bad debts and/or delinquent SPAs.
- Formalise follow up actions on delinquent SPAs and timely termination of delinquent contracts at the end of grace period.

Item (i) to (iii) of the preceding paragraphs are collectively referred to the “**Additional Controls**”.

The AC has reviewed and approved the implementation of the Additional Controls.

The Company will engage the help of its internal auditors to follow up on the implementation of the Additional Controls, and/or to review the scope of the internal audit to be conducted for the Group at an appropriate time. Based on the above findings and recommendations of RSM as set out in the Report, the AC and the Board are of the view that the Additional Controls, in addition to the Group’s existing internal controls, will be adequate and effective for the internal controls of the Group.

**On behalf of the Board of Directors of  
PACIFIC STAR DEVELOPMENT LIMITED**

**Ying Wei Hsein  
Executive Chairman  
10 October 2019**

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This announcement has been reviewed by the Company’s Sponsor, SAC Capital Private Limited (the “Sponsor”).

This announcement has not been examined or approved by the Singapore Exchange Securities Trading Limited (the “SGX-ST”) and the SGX-ST assumes no responsibility for the contents of this announcement including the correctness of any of the statements or opinions made or reports contained in this announcement.

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