Consultative Document on the Proposal of the New Audit Exemption Criteria for Private Companies in Malaysia

A public consultation issued by Suruhanjaya Syarikat Malaysia (SSM), The Companies Commission of Malaysia

Comments from ACCA to SSM
8 March 2024
TECH-CDR-2101

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GENERAL COMMENTS

ACCA appreciates the opportunity to offer feedback on the proposed new audit exemption criteria for private firms in Malaysia, as outlined in the consultative document published by the Companies Commission of Malaysia (SSM) on 7 February 2024.

We note that this is the second time the SSM has sought feedback on its review of the extant audit exemption criteria introduced on 4 August 2017 via Practice Directive No.3/2017. The SSM has revised its proposed new criteria following responses from the February 2023 exercise, leading to the current consultation.

The latest changes are significant, and we believe that the new audit exemption criteria will likely have a broad and significant impact if implemented. It is therefore in the interest of SSM to mobilise all stakeholders affected by the changes and encourage as many responses as possible to facilitate a robust understanding and review of the implications, including any unintended consequences, from the proposed changes.

It is in that spirit that many within our community have expressed concerns over the constricted time frame for the consultation. The consultation document was released only three days before the start of the Lunar New Year celebrations. Given that many people were on holiday for an extended period as part of the celebrations, the ability of many to carefully consider the proposal is curtailed. For ACCA, the window to engage with our members and stakeholders was significantly reduced, and we had limited time to work on our response.

We hope the SSM will extend the consultation period and engage with everyone who is affected by the proposed changes so that they have the chance to share their views.

While the short timeline for consultation has impeded our ability to perform more extensive outreach and formulate a fully considered position, we have sought to take into account the interests and perspectives of a broad range of stakeholders in arriving at our comments.

In the absence of consultation questions posed by the SSM that we could directly address, we have based our comments on key matters raised during our engagement with members and other stakeholders.

We are in full alignment and support of SSM's view that it is "crucial to strike a balance between providing cost relief to smaller businesses and ensuring adequate oversight on financial reporting". The expected surge in SMEs not subject to independent audits may have profound and enduring implications for the trustworthiness and integrity of the corporate sector, including supply chains, and the resilience of the broader economy.

We strongly recommend that should the proposed changes be proceeded with, specifically the threshold increases, they should be implemented gradually over a longer period. Through our outreach, stakeholders are proposing a phased approach, starting with thresholds of RM500,000and increasing to RM3 million over a period of five years. This will allow stakeholders more time and space to adjust and respond to shifting market forces.

We are concerned that the conduct of independent audits is conflated with administrative burdens. The rationale articulated in the consultative document for increasing audit exemption thresholds inadvertently implies that financial statement audits and the services of audit and accounting practitioners are of little or no value to SMEs. We therefore urge SSM, working with fellow regulators and other industry partners, to invest in educating stakeholders on the importance and benefits of audits. This helps to mitigate any incorrect perception about the value of audit and will either prompt SMEs to consider having an audit done voluntarily, or prompt stakeholders of SMEs, for example their bankers or major customers, to demand for an audit to be performed.

A potential unintended and severe consequence of an abrupt and significant increase in audit exemption thresholds is that it may diminish attractiveness of the accountancy profession. There is a real risk that employment opportunities will be significantly reduced. Coupled with a perceived change in the value of an audit, as mentioned above, young talents may be deterred from pursuing opportunities in the accountancy profession. It is therefore critical that the scale and timeline of the new exemption criteria are carefully calibrated to allow SMPs to pivot and adapt to the expected drop in SME audits.

We firmly support SSM's intent to strengthen the enforcement regime to deter misconduct and maintain accountability. SSM should ensure that it retains, and indeed, enhances regulatory power over those charged with governance and be unequivocal about its ability and intention to impose severe penalties for wilful misreporting of financial information.

We would like to also underscore the importance of monitoring the impact of the exemption on an ongoing basis. This is essential to ensure that the criteria and associated policy decisions remain relevant in the prevailing business and economic conditions. Periodic reviews and a transparent feedback mechanism allow for adjustments to be made in response to any fundamental change in market dynamics, risks that may emerge, and any unintended consequences.

SPECIFIC COMMENTS

Concerned that new criteria may exempt too many too soon

The pool of companies eligible for audit exemption is expected to increase significantly based on the new proposed criteria.

The proposed changes to the exemption criteria include streamlining how companies can qualify for audit exemption, and significantly raising the maximum thresholds. Currently, companies seeking exemption must be either dormant, zero-revenue, or threshold-qualified companies. The thresholds are annual revenue of RM100,000, total assets of RM300,000, and a headcount of five.

SSM is proposing to replace the three categories of exemption with a simple test and with higher turnover, assets, and employee thresholds. Specifically, RM3 million for both turnover and assets, and 30 for the number of employees. Additionally, the proposed new criteria allow companies that meet any two of the three thresholds to be exempted from an audit, instead of needing all three to be fulfilled under the current criteria.

Based on our outreach, our stakeholders shared that very few SMEs will exceed the new employee threshold. Government statistics for 2022 show that the Malaysian SME sector comprised 1.17 million entities and provided jobs for 7.59 million people. That works out to an average of fewer than seven employees per SME. In addition, with more businesses turning to less human capital-intensive solutions such as outsourcing, automation, digitalisation, and ecommerce, it is expected that almost all SMEs will be able to meet the employee threshold of 30 by default. So, in most cases, only one of the other thresholds need to be met.

According to SSM's records as at July 2023, 77.4% of financial statements submitted to the SSM reported turnover of less than RM3 million, while those with total assets below RM3 million make up 74.3%.

Based on the above, it is anticipated that once the new criteria come into effect, a very significant number of SMEs will be eligible for the exemption and may choose not to have their financial statements audited.

Assessment of present and potential impact

Policy proposals need to be underpinned by empirical evidence and a detailed analysis of known and potential impacts. Such analysis should be transparent and made available to participants to the consultation to facilitate an informed deliberation and debate, and to ensure that decisions are grounded in full understanding and consideration of anticipated outcomes.

The SSM's consultative documents on the subject issued in February 2023 and last month respectively contained some sets of data but, in our outreach, stakeholders shared concerns that these do not appear to be cohesive and comprehensive enough to substantiate the much higher audit exemption thresholds proposed.

For example, the most recent consultative document provides a summary of the feedback received on the February 2023 consultation. The SSM states that 65% of the respondents agreed with the proposal to raise the exemption thresholds as laid out in the February 2023 document, while 21% opposed the move. The rest neither agreed nor disagreed. The document also indicates that among respondents who agreed, 55% believed that the thresholds should be higher to align with other jurisdictions. It is, however, unclear if more in-depth analysis of the feedback was undertaken, including reviewing the views expressed based on the profile of respondents. Small business managers and owners may be more inclined to vote one way and auditors, the other. At the same time, it is essential to check if the views of less vocal but equally important stakeholders are captured. In this case, bankers and other providers of capital, as well as larger organisations that count on SMEs as part of their supply chains have an important stake in the decision. Counting the number of ‘for’ and ‘against’ is often less meaningful than complete airing of the issues, thorough and meticulous gathering and evaluation of views and ideas, including ensuring that all impacted stakeholders are engaged. The case for the new exemption thresholds must be supported by a full impact assessment that makes clear the potential costs and benefits of the proposed criteria.

Our stakeholders appreciate the fact that the consultative document is succinct and eminently readable. They would, however, prefer more comprehensive sharing of impact analysis considered by SSM, which supports the very substantial jump in the proposed exemption thresholds, when compared to the proposed amounts in the February 2023 consultative document.

We are in full alignment and support of SSM’s view that it is “crucial to strike a balance between providing cost relief to smaller businesses and ensuring adequate oversight on financial reporting”. The expected surge in SMEs not subject to independent audits may have profound and enduring implications for the trustworthiness and integrity of the corporate sector, including supply chains, and the resilience of the broader economy.

Accountancy Europe, the representative body for accountants and professional accountancy organisations in Europe, periodically review the audit exemption thresholds set up in countries within Europe. Their latest report published in April 2021[1] made the following observations, among others:

- Italy significantly lowered their audit exemption thresholds, recognising that smaller companies that were not subject to any audit or control system had been the first ones to become insolvent. It was also acknowledged that a certain level of controls and early-warning mechanisms could be useful to avoid business failure.
- There was a political discussion in Denmark about potentially lowering audit thresholds, sparked by a series of stories in the media about fraud in companies that had not been audited.
- In Sweden, a study[2] conducted by an independent body of the Swedish Parliament demonstrated through an impact assessment that audit of small entities is valuable to both these entities and the public good. Specifically, exempting them from audit increases the risk of accounting errors, tax evasion and economic crime.

The experience of the above jurisdictions serves as a cautionary narrative, reminding us to approach the proposed increase in audit exemption thresholds with care. The observations made by Accountancy Europe also indirectly provide a compelling testimony to the value of audits for SMEs, further discussed in the next section.

Therefore, we strongly recommend that should the proposed changes be proceeded with, specifically the threshold increases, they should be implemented gradually over a longer period. Through our outreach, stakeholders are proposing a phased approach, starting with thresholds of RM500,000 and increasing to RM3 million over a period of five years. This will allow stakeholders more time and space to adjust and respond to shifting market forces.

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[1] Audit exemption thresholds in Europe - Accountancy Europe

[2] Abolition of audit obligation for small limited companies – a reform where costs outweigh benefits (RiR 2017:35) (riksrevisionen.se)

Value of audit for SMEs

We are concerned that the conduct of independent audits is conflated in this consultation with administrative burdens. The rationale articulated in the consultative document for increasing audit exemption thresholds inadvertently implies that financial statement audits and the services of audit and accounting practitioners are of little or no value to SMEs.

A financial audit enhances financial reporting quality, deters fraud, and protects the interests of providers of financial capital. Apart from building trust and creditability, as well as enhance access to finance, auditors are often regarded as the trusted advisor to resource-strapped SMEs, and over the course of their audit, may help detect operational weaknesses and non-compliance with legal and regulatory obligations.

It can be argued that if the value of audit is so evident, SMEs will continue to engage qualified auditors. Our concern is that many SMEs may take a narrow view and prioritise immediate cost savings from the audit fees, eliminating access to professional support that can steer them towards establishing effective financial oversight, which is vital for longer term growth, funding and innovation.

We therefore urge SSM, working with fellow regulators and other industry partners, to invest in educating stakeholders on the importance and benefits of audits. This helps to mitigate any incorrect perception about the value of audit and will either prompt SMEs to consider having an audit done voluntarily, or prompt stakeholders of SMEs, for example their bankers or major customers, to demand for an audit to be performed.

Attractiveness of the profession

A potential unintended and severe consequence of an abrupt and significant increase in audit exemption thresholds is that it may diminish attractiveness of the accountancy profession.

Audit has traditionally been the training ground of choice for those who have just passed their professional examinations. The exposure to a broad range of businesses and industries provides a steep learning curve that fortifies the trainees' core accounting skills and competencies, allowing them to obtain solid practical experience to develop into full-fledged professional accountants.

The new exemption criteria are expected to have a major impact on small and medium practices (SMPs) that have many SMEs as audit clients. With the anticipated loss of a significant portion of their audit jobs, these SMPs will have to cut down on their hiring, and at the same time, they will likely be viewed as less attractive employers. These SMPs, which have been an integral part of the business community and have supported the growth of SMEs over the years, might also struggle to stay afloat when a substantial part of their audit portfolio is affected.

There is a real risk that employment opportunities will be significantly reduced. Coupled with a perceived change in the worth of an audit, as discussed in the preceding section, young talents may be deterred from pursuing opportunities in the accountancy profession.

Already struggling with talent shortage, the profession will probably face even greater difficulties if the scale and timeline of the new exemption criteria are not carefully calibrated to allow the SMPs to pivot and adapt to the expected drop in SME audits.

It is important to note that the impact on attractiveness of the profession and talent shortage is not contained within the SMPs sector. Professional accountants trained in SMPs have traditionally gone on to work in other sectors, including as accountants in business, in the public sector and in academia. They are also highly sought after in larger firms.

Regulation and enforcement

In the consultative document, the SSM clarifies that in tandem with the implementation of the new audit exemption policy, the commission will strengthen its enforcement by closely monitoring and collaborating with professional bodies to establish clear procedures towards ensuring that financial reporting practices in Malaysia align with industry standards and international norms.

We firmly support SSM's intent. We believe that commensurate regulatory enforcement mechanism is critical to partly compensate for any further increase in audit exemptions.

SSM should ensure that it retains, and indeed, enhances regulatory power over those charged with governance. To deter misconduct and maintain accountability, the SSM needs to put in place a more robust oversight regime and be unequivocal about its ability and intention to impose severe penalties for wilful misreporting of financial information. It also sends an important and strong message about SSM's interest in the financial integrity and health of SMEs, to dispel any misconception that may arise from the increased audit exemptions.

We would like to also underscore the importance of monitoring the impact of the exemption on an ongoing basis. This is essential to ensure that the criteria and associated policy decisions remain relevant in the prevailing business and economic conditions. Periodic reviews and a transparent feedback mechanism allow for adjustments to be made in response to any fundamental change in market dynamics, risks that may emerge, and any unintended consequences.