8-2015

Amendments to the companies act – Audit exemption for small companies

Pey Woan LEE
Singapore Management University, pwlee@smu.edu.sg

18 August 2015

SINGAPORELAWBLOG

Amendments to the Companies Act – Audit Exemption for Small Companies

Introduction

The first phase of legislative amendments introduced by the Companies (Amendment) Act 2014 took effect on 1 July 2015. Of these amendments, the most significant is arguably the introduction of the "small company", which replaces the exempt private company for purposes of audit exemption. This article considers the features of this new regime and illustrates its application to existing as well as new companies.

Small company

The small company differs from the exempt private company in that it is defined by a broader set of criteria, reflecting the fact that audit is of value to a broader group of stakeholders (e.g. creditors, employees and customers) than shareholders. With the introduction of this new set of criteria, more companies will qualify for audit exemption, thus reducing compliance costs and creating a more business-friendly environment overall.

Paragraph 2 of the Thirteenth Schedule of the amended Companies Act (Cap 50, 2006 Rev Ed) (hereafter the "Thirteenth Schedule") states that a company is a small company *from* a particular financial year if:

(a) it is a private company throughout the financial year; and
(b) it satisfies any 2 of the following criteria (hereafter the "quantitative criteria") for each of the 2 consecutive financial years immediately preceding the financial year:
    (i) the revenue of the company for each financial year does not exceed $10 million;
    (ii) the value of the company's total assets at the end of each financial year does not exceed $10 million;
    (iii) it has at the end of each financial year not more than 50 employees.

These quantitative criteria are consistent with the approach adopted by the Singapore Financial Reporting Standards for Small Entities (accessible at http://www.asc.gov.sg/SFRS-for-Small-Entities) but incorporate the additional requirement that the small company's status be determined by reference to a historical two-year period. The precise reason for this requirement is unclear, but a couple of justifications may be suggested. The first is the need to safeguard against opportunistic manipulation of earnings in order to achieve audit-exemption status. Secondly, assessing eligibility on the basis of a two-year time frame reduces the impact of volatile or abnormal earnings. So a company that has qualified for audit-exemption will not lose the exemption status by reason only of an exceptional blip in its earnings (see, further, the discussion on Cessation in paragraph 6 below).

Small group

A company that is a member of a group (either as a parent or a subsidiary company) will not qualify for exemption unless it is itself a small company and the group qualifies as a small group. A small group is one that meets the quantitative criteria for a small company on a consolidated basis (see paragraph 7 of the Thirteenth Schedule). For this purpose, a "group" and the method of consolidation are determined by reference to the relevant accounting standards.

Transitional provisions

As the new regime takes effect only in respect of a financial year commencing on or after 1 July 2015, transitional arrangements are made for companies formed before that date. Such a company will qualify as a small company from the first or second financial year commencing on or after that date if it is a private company throughout that financial year and also meets the quantitative criteria for that particular financial year (see paragraph 4 of the Thirteenth Schedule). Likewise, a group that was formed before 1 July 2015 will qualify as a small group in the first or second financial year commencing after that date if it meets the quantitative criteria for that year on a consolidated basis (see paragraph 9 of the Thirteenth Schedule).

Illustration:

- *Alpha Pte Ltd was incorporated on 31 July 2005. Its financial year ends on 30 September of each year.*
- *In FY 2015 – 2016, it meets the quantitative criteria.*
- *It qualifies as a small company and is exempt from audit from FY 2015–2016 even if it did not satisfy the quantitative criteria in the last two financial years.*

New companies

Equally, a new company incorporated on or after 1 July 2015 can be exempted from audit from its first or second financial year if it is a private company throughout that year and meets the quantitative criteria for that particular financial year (see paragraph 3 of the Thirteenth Schedule). A similar treatment is applicable to small groups formed on or after 1 July 2015 (see paragraph 8 of the Thirteenth Schedule).

Illustration:

- *Beta Pte Ltd was incorporated on 31 July 2015. Its first financial year ends on 30 September 2016.*
- *It does not satisfy the quantitative criteria for FY 2015 – 2016 but meets those criteria in FY 2016 – 2017.*
- *Beta qualifies as a small company and is exempt from audit from FY 2016–2017 even though it has not met the quantitative criteria for two immediate past financial years.*

Cessation

Once a company is conferred audit-exemption status, it will continue to enjoy the privilege until it ceases to be a small company in accordance with paragraph 5 of the Thirteenth Schedule. This occurs when the company ceases to be a private company at any time during a financial year, or when it fails to satisfy the quantitative criteria for the two immediately preceding financial years. Similarly, a group will cease to be a small group from a particular financial year if it fails to meet the quantitative criteria for two consecutive financial years immediately preceding that financial year (see paragraph 10 of the Thirteenth Schedule). However, a company disqualified as a small company may reacquire exemption status if it subsequently meets the general criteria described in paragraph 2 above.

Illustration:

- *Gamma Pte Ltd has qualified as a small company since FY 2015 - 2016.*
- *In FY 2016 – 2017, Gamma fails to satisfy the quantitative criteria but this has no effect on its "small company" status.*
- *Gamma satisfies the quantitative criteria in FY 2017 – 2018.*
- *Between 2018 – 2020, however, Gamma fails to meet the quantitative criteria for two consecutive financial years.*
- *Gamma ceases to qualify as a small company from FY 2021 – 2022.*

Conclusion

With these changes, Singapore's audit-exemption regime is now broadly in line with those of leading jurisdictions such as UK and Australia. The resulting expansion in the scope of exemption underscores the regulatory belief that the audit imposes an unwarranted burden on smaller companies. One may, of course, question whether a more liberal exemption regime would compromise accountability, particularly to creditors. Indeed, the risks to creditors appear to have been compounded by the retention of the exempt private company ("EPC") regime, which effectively preserves the privilege of secrecy for a large number of companies as EPCs are not required to file financial accounts with

ACRA. Indisputably, these are legitimate concerns that have to be weighed when striking a balance between regulatory burden and creditor protection. For now, the regulator appears to have accepted that the benefits of an expanded audit-exemption regime outweigh the costs.

For the reader's convenience, we append below a table summarising the rules discussed above.

The Small Company and Small Group in Summary

	Small Companies	Small Groups
Definition	A company is a small company from a FY if – (a) it is a private company throughout the FY; and (b) it satisfies the quantitative criteria for each of the 2 FYs immediately preceding the FY.	A group is a small group from a FY if it satisfies the quantitative criteria on a consolidated basis for each of the 2 consecutive FYs immediately preceding that FY.
Quantitative Criteria	Any two of the following three criteria: (i) the revenue of the company for each FY does not exceed $10 million; (ii) the value of the company's total assets at the end of each FY does not exceed $10 million; (iii) it has at the end of each FY not more than 50 employees;	
Existing companies / groups (Transitional provisions)	<u>1st FY after 1 July 2015</u> Qualifies as small company if it satisfies the quantitative criteria for that FY.	<u>1st FY after 1 July 2015</u> Qualifies as small group if it satisfies the quantitative criteria on a consolidated basis for that FY.
	<u>2nd FY after 1 July 2015</u> Qualifies as small company if it satisfies the quantitative criteria for that FY.	<u>2nd FY after 1 July 2015</u> Qualifies as small group if it satisfies the quantitative criteria on a consolidated basis for that FY.
New companies / groups	<u>1st FY after incorporation</u> Qualifies as small company if it satisfies the quantitative criteria for current FY.	<u>1st FY after formation</u> Qualifies as small group if it satisfies the quantitative criteria on a consolidated basis for current FY.
	<u>2nd FY after incorporation</u> Qualifies as small company if it satisfies the quantitative criteria for current FY.	<u>2nd FY after formation</u> Qualifies as small group if it satisfies the quantitative criteria on a consolidated basis for that FY.
Cessation	A company ceases to be a small company from a FY if it has failed to fulfill the quantitative criteria in the last two consecutive FYs.	A group ceases to be a small group from a FY if it has failed to fulfill (on a consolidated basis) the quantitative criteria in the last two

	(Does not apply to a company that has not reached its 3rd FY after incorporation and an existing company that has not reached its 3rd FY after 1st July 2015)	consecutive FYs. (Does not apply to a group that has not reached its 3rd FY after formation and an existing group that has not reached its 3rd FY after 1st July 2015)
Re-qualifying after cessation	A company that has ceased to be a small company may become a small company again if it subsequently meets the quantitative criteria for two consecutive FYs.	A group that has ceased to be a small group may become a small group again if it subsequently meets the quantitative criteria for two consecutive FYs.

Lee Pey Woan
(Associate Professor, Singapore Management University)

Rachel S Chin
(Singapore Management University)

* This blog entry may be cited as Lee Pey Woan and Rachel S Chin, "Amendments to the Companies Act – Audit Exemption for Small Companies", Singapore Law Blog (13 August 2015) (http://www.singaporelawblog.sg/blog/article/129)