# DIRECTORS' VIEW ON EXEMPTION FROM STATUTORY AUDIT

INSTITUT PENGURUSAN PENYELIDIKAN

UNIVERSITI TEKNOLOGI MARA

40450 SHAH ALAM, SELANGOR

MALAYSIA

BY:

PM Dr Rohana Othman
Prof Dr Zubaidah Zainal Abidin
PM Dr Nagerathnam Thirumanickam
PM Dr Jagjit Kaur

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## Abstract

Fundamentally, an audit is important to inform shareholders about the well being of the company's finances. An audit helps the shareholders as well as stakeholders to make informed decisions based on how the company is performing. In recent years, the issue of audit exemption among small companies has been addressed in many studies in the United Kingdom, Australia and Singapore. Over the years, these countries and several others have exempted small companies from the annual audit requirement. Malaysia still legally obligates all her companies, irrespective of their size, to undergo annual audit. This study explores factors that may be associated with the take-up level of audit exemption among SMEs in Malaysia namely; value of audit, financing strategy, future plans, size of firms, director's qualification, dependent users and audit cost. Results indicate that all six factors have a significant relationship with the take-up level of audit exemption with the exception of director's qualification. The majority of SMEs in this study chose to continue with statutory audit even if they are not legally required to do so, showing that there is a low take-up level of audit exemption among SMEs. The results from this study provide useful information for policy makers, auditors and directors of small companies.

# CHAPTER ONE

# INTRODUCTION

## 1.0 Preamble

Companies in Malaysia are governed by the Companies Act 1965, which protects the rights and interests of shareholders and investors. The Act also provides regulations for the incorporation and formation of companies as well as their operations in Malaysia. Section 169(1), Section 174(1) and Section 174(2) of the Act denote that all companies in Malaysia regardless of their size, private or public, need to have their annual accounts audited by an independent auditor.

The fundamental purpose of audit is to inform shareholders about how the directors have managed the company's finances on behalf of the shareholders. Therefore, an audit helps the shareholders as well as stakeholders to make informed decisions based on how the company is performing. It provides assurance about the company's account when deciding whether they wish to invest in, provide finance to or to trade with that company.

The need for audit can be explained based on two theories; stewardship and agency theories (Fama and Jensen, 1983). Stewardship theory suggests that the management is hired to act in the best interests of the company's owner. With the agency theory, due to the separation of ownership and control, the management has more information about the company and its businesses compared to its owner. This information asymmetry adversely affect the owner's ability to effectively monitor if the management has acted on their best interests (Jensen and Meckling 1976). Goddard and Masters (2000) imply that one of the ways to monitor the management is through the annual accounts whose reliability is enhanced by the audit report. With these thoughts in mind, one realizes that an audit is necessary in order to ensure that the accounts have been prepared in accordance with the provisions of the Companies Act 1965 and reflect a true and fair view of the company's affairs.