

## DIRECTORS' VIEW ON EXEMPTION FROM STATUTORY AUDIT

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### ABSTRACT

*Fundamentally, an audit is important to inform shareholders about the well-being of the company's finances as it helps shareholders as well as stakeholders to make informed decisions based on the company's performance. The current trend is however to exempt small companies from the annual audit requirement. Many studies in the United Kingdom, Australia and Singapore have addressed the issue of audit exemption for small companies. Over the years, these countries and several others have exempted small companies from the annual audit requirement. In Malaysia, it is a statutory requirement for all companies registered with the Companies Commission of Malaysia to have their annual accounts audited. However this statutory requirement is currently being reviewed to allow for an audit exemption for small companies. This study therefore explores factors that may be associated with the take-up level of audit exemption among small medium enterprises (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.*

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**Keywords:** Audit, Audit Exemption, Small Companies

### INTRODUCTION

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 an audit is to inform shareholders about how the directors have managed the company's

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finances on behalf of the shareholders. Therefore, an audit helps the shareholders as well as stakeholders to make informed decisions based on its performance. These interested parties can then decide whether to invest, provide finance to or to trade with the company. The need for audit can be explained based on two theories; stewardship and agency theories (Fama and Jensen, 1983). Stewardship theory suggests that management is hired to act in the best interests of the company's owner. Agency theory documents that, due to the separation of ownership and control, management has more information about the company and its businesses compared to its owner. This information asymmetry adversely affects the owner's ability to effectively monitor if the management has acted in their best interests (Jensen and Meckling, 1976). Goddard and Masters (2000) imply that one of the ways to monitor the behavior of management is via the production of annual financial statements. To enhance the verifiability of the financial statements prepared by the management, 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. Abdul Aziz (2002) provides evidence that over the years countries such as the United Kingdom (UK), United States of America (USA), Singapore, Australia and several other countries in Europe have exempted small companies from the annual audit requirement, while Malaysia continues to legally obligate all companies irrespective of their size, to be annually audited. In the UK, the audit exemption legislation came into effect on 11 August 1994, exempting small companies with an annual turnover not in excess of £90,000 and balance sheet totals of not more than £1.4 million. In Australia, the exemption of audit is given on a case to case basis, upon application by the directors of the respective company (Abdul Aziz, 2002). Effective from June 2004, Singapore companies with a turnover of less than S\$5 million are exempted from audit (IRAS, 2004). In the USA, there is no statutory audit requirement for companies other than listed companies (ICPAS, 2000).

The main motivation for audit exemption among small companies is an audit is costly and burdensome. Removing the need for an audit can reduce costs and save management time in preparing their annual accounts. Furthermore, many small companies in Malaysia are managed by their owners where both the directors and shareholders are the same person. In this case, the directors who also are the shareholders of the company would essentially be reporting to themselves. Since they have access to financial information on a daily basis, they could still arrange for an audit should they require one in the future. Therefore, the audit check on the directors' trusteeship becomes unnecessary. In many cases, small companies tend to have a lesser impact on the economy and are not likely to be a target of major fraud. And yet, they are burdened with the statutory requirement for their annual accounts to be audited. The question raised is whether audit should be a statutory requirement for small companies. The nature and size of many small companies do not justify a mandatory, statutory audit because the benefits for management and third parties are minimal compared to the cost incurred. This study will provide evidence on the views of directors' of small companies in Malaysia on exemption from statutory audit. In Malaysia,

the amendment to the Companies Act to grant audit exemption to small companies is currently under revision. The outcomes of the analysis will help to identify factors that may influence the take-up levels of audit exemption for SMEs. This study is beneficial for regulatory and professional bodies on the implementation of audit exemption, not only in Malaysia but also in countries who are contemplating the possibility of audit exemption for small companies.

## **LITERATURE REVIEW and HYPOTHESES DEVELOPMENT**

An external audit brings important benefits for companies, as well as for regulators, shareholders and other stakeholders (ICPAS, 2000). The major reason why some small companies continue to be audited is to help control the conflict of interests among managers, shareholders and external creditors (Taurigana and Clarke, 2000). Audit provides these users of financial statements reasonable assurance that the reports are prepared in compliance with accounting standards and ensure the credibility of its information. By having this kind of assurance, the financial statements users will be able to rely on the information in order to make important strategic and financial decisions. The Collis Report 2003 which was commissioned by UK's Department of Trade and Industry (DTI) shows that the main benefits of audit perceived by directors and senior management are that it improves the credibility of the financial information and provides a check on the accounting records. Tabone and Baldacchino, (2003) highlight the relevance of a mandatory annual statutory audit requirement for owner-managed companies. Their study concludes that statutory audit fulfils two important roles. Firstly, it is relevant to external third parties such as bankers, lenders and tax authorities who have no direct ownership interest in the company but who nonetheless contribute to the viability of the enterprise. Secondly, the statutory audit has a positive effect on the owner-manager and staff not so much by detecting material fraud and error contained in the financial statements, but by imposing financial discipline and providing specialist advice in other non-audit areas.

Qually, (2002) states that the role of auditors in the past, as supported by the Companies Act and auditing, has been to bring credibility to audited financial statements by providing a true and fair opinion on the financial information. He further clarifies that neither of the Act nor the auditing standards explicitly states that the purpose of an audit is to protect investors or to promote public interest. Nevertheless, corporate failures involving big companies such as Enron have eroded confidence in the audit report. Auditors are now expected to provide more protection to investors and act more in the public interest. As a result, an expectation gap exists between client-auditor relationships. According to Zikmund (2008), the expectation gap reflects a perceived difference between what one is expected to accomplish by others and what one personally believes he must accomplish. In this case, an auditor is expected to possess the skills to detect fraud and uncover red flags while auditing the financial statements. Failure to do so may result in the clients becoming dissatisfied with the auditor's quality of service and consequently reduces the value of audit in the

eyes of the clients. A study done by Fadzly and Ahmad in 2004 revealed substantial evidence on the expectation gap in Malaysia particularly on issues concerning auditor's responsibilities. The study disclosed that a wide gap was found with regards to auditor's responsibilities to detect and prevent fraud. Despite evidence of the expectation gap, the study found that users of financial statements in Malaysia still believe that auditors are trustworthy.

Today, auditors face challenges when it comes to detecting fraud in an audit. Clients, shareholders and other parties expect auditors to take steps to detect fraud during the audit. They are often displeased when fraud goes undetected and is later uncovered through a tip or by accident (Zikmund, 2008). Even so, Collis (2003) in her survey found that 50 percent of respondents considered that audit helped to protect against fraud and as the size of the company grew, they would consider having a voluntary audit. The audit process includes checks to identify the existence of fraud and to assess the adequacy of the company's internal control (Davies, 2004). Additionally, while auditors cannot be expected to develop these skills to the level of a fraud examiner, they should try to become more proficient through training, hands-on experience, brainstorming and using fraud detection skills during an audit (Zikmund, 2008). In light of a series of recent high-profile corporate failures, a growing debate on the value of audit has developed among academicians and regulators. A survey done by KPMG in 2007 suggests that around half of SMEs are missing out on an opportunity to generate greater value from their audit. Approximately 56 percent of SMEs in the survey see their audit as a routine chore that varies little from year to year while only 40 percent of them agree that the audit raises issues and learning points that are useful for the business. Notably, 62 percent of SMEs claim that they would conduct their own audit process even if it were not a statutory obligation. These findings lead to the conclusion that most SMEs in the survey do value audit as a process that has the potential to generate insights and learning points that are useful for the company. However, they need to ponder whether they are getting the value they could be getting out of their annual audit. Based on the above arguments, the following hypothesis is formulated:

H<sub>1</sub>: The value of audit will significantly influence the take-up level of audit exemption

When companies need to extend their loans and finances, banks or other lenders would want to assess the credit worthiness of the companies. The audited accounts will be considered to be the trusted form of check on the credit worthiness of these companies. Thus, firm without a statutory audit may have difficulties in convincing the lending bodies on their financial health. A survey done by ICPAS (2000) showed that the audited financial statements were useful in dealings with banks and other lenders, leasing companies, suppliers of goods and services, the tax authorities, and other governmental agencies. In this study, bankers said that they rely on audited accounts before granting or extending credit facilities.

Tauringana and Clarke, (2000) state that, if lenders base their credit granting decision on unaudited financial statements, they may be likely to suffer financial losses. Therefore, lenders may demand the financial statements to be audited before they can rely on them because the audited financial statements are the best assurance they have of the company's financial status. In their article, they quoted a study done by Strawser in 1994 that also suggest bank loan officers are more likely to grant loans to companies providing audited financial statements, and that lenders associate greater reliability with such statements. This proves that audit aids companies in gaining finance and raising capital. Based on this need, if an audit exempted company requires financing, then it may have to request for a special purpose audit, which may be more costly. Subsequently, if the company plans to raise finance through the sale of shares, the audited financial statements will facilitate the transaction, as potential investors will feel assured with the audited accounts. Hence, it can be seen that the financing strategy adopted by companies may influence the need for a statutory audit. However, based on the argument that banks are a party to a company's bank account at first hand and are also in receipt of regular management accounts, the need for a statutory audit for bank financing might not be as crucial. Based on these arguments, the following hypothesis is formulated:

H<sub>2</sub>: The financing strategy of a company will significantly influence the take-up level of audit exemption

The future plans of a business entity can be an influencing factor on the decision for an audit exemption. Companies that are expanding may view the audit exemption to be less attractive because once their turnover exceeds the audit exemption requirement, then they would be required to prepare the audited accounts. Furthermore, companies with the intention to be listed or intending to secure financing or credit also find the audit exemption to be unappealing due to the need to prepare the audited accounts in the future (ICPAS, 2000). The hypothesis is thus formulated as follows:

H<sub>3</sub>: The future plans of a company will significantly influence the take-up level of audit exemption

Bartram, (2004) reported that the Department of Trade and Industry (DTI) in the United Kingdom (UK) estimated that 69 percent of new companies will seek audit exemption. He attributed this to the fact that the larger the company, the less likely it is to seek exemption. Collis (2003) suggested that small companies aspiring to become large companies will be more likely to continue to have the accounts audited. A research by Collis et al. (2004) supports this fact and finds that only 21 percent of the companies in the £1 million to £5.6 million turnover band are likely to seek audit exemption. Growing companies may also find audit exemption less attractive as once the turnover threshold is exceeded, they would no longer be eligible for the exemption (Kenny, 2005). The hypothesis is thus formulated as follows:

H<sub>4</sub>: The size of a company will significantly influence the take-up level of audit exemption

Collis et al. (2004) point out that the main users of the accounts are the directors and the lenders. Directors who are highly qualified in business and management disciplines are more likely to appreciate the value of an audit. Collis (2001) as cited in Collis (2003) finds that qualified directors acknowledged that the practical benefits of voluntary audit exceed the costs of conducting an audit. The benefits of an audit have also been succinctly discussed in earlier studies (ICPAS, 2000). Nevertheless, Davies (2004) argues that the quality of director's decision making depends on the quality of the financial report itself. Qualified directors who have the expertise will themselves be able to scrutinize and check on the quality of the reports. Hence, there may not be a need for an external audit. However, if directors are not qualified in the appropriate areas, they may prefer to rely on audited financial statements as this ensures quality of the information. The hypothesis is thus formulated as follows:

H<sub>5</sub>: The director's qualification will significantly influence the take-up level of audit exemption

Davies (2004) reported that the biggest criticism of the legal necessity for the audit usually comes from very small companies in which the directors and shareholders are one and the same. This is supported by Kenny (2005) who states that an audit is an unnecessary burden where the directors and the shareholders are the same and where the stakeholder and public interest are low. However companies which rely on external finance and credit would be more hesitant to avail themselves for audit exemption (Kenny, 2005; Davies, 2004). Banks or other lenders invariably require audited accounts as evidence to base their lending decision. Traditionally, the Inland Revenue Board (IRB) has also used audited accounts as a basis for determination of tax liability (Davies, 2004). As a result, the IRB may wish to seek more clarification from companies that do not submit audited accounts. The hypothesis is thus formulated as follows:

H<sub>6</sub>: The dependent users of the company will significantly influence the take-up level of audit exemption

The main reason for taking up the audit exemption is the cost factor. For small companies, particularly owner-managed companies, where the non-audit risk is low, an audit is considered to be a burden, both financially and administratively (Freedman and Goodwin, 1993). Nevertheless, the audit fee savings may not be a permanent feature. The audit exemption report (ICPAS, 2000) argues that the savings from not having an audit in one year may result in higher audit fees for the subsequent years when the company disqualifies itself based on the exemption thresholds, or when certain stakeholders request an audit. A higher audit fee is the consequence of the absence of a history of audit. The report strongly recommended on retaining the mandatory audit requirement

for companies in Singapore. However, effective from June 2004, companies in Singapore with a turnover of less than S\$5 million are exempted from audit (IRAS, 2004). With such reasoning, the following hypothesis is developed:

H<sub>7</sub>: The cost of audit will significantly influence the take-up level of audit exemption

## **RESEARCH METHODOLOGY**

The study was designed as a postal questionnaire survey of the directors of SMEs in Malaysia as it was intended to capture the views and practices of those that were likely to qualify for audit exemption, should it be implemented in Malaysia in the future. A list of companies was randomly selected from the Federation of Malaysia Manufacturers Directory 2005. To narrow down the sample size, the list has been screened to remove dormant companies in order to retain only active independent companies registered in the Klang Valley. Independent companies were selected because their financial reporting decision would not be influenced by group policies. Since the opinions of the directors of small companies are important to have a better perspective on the value of audit (Collis, 2003), the participating group for the study include directors of the SMEs listed in the directory. Companies that had not provided the names of directors were eliminated. As a result, 1000 companies were selected in the survey. Only 46 responses were received giving a response rate of 4.6 percent. The questionnaire for this study was adopted from Collis, (2003) and divided into four sections. The first section covers the perception on the value of audit. The second section seeks the respondents' view on the audit cost and financing policy while the third section indicates the company's outsourced accounting function. The last section gathers the demographic information about the respondents.

## **FINDINGS**

### **Descriptive analysis**

In terms of audit cost and financing policy, the respondents' main external sources of finance are the banks (73.91 percent of companies), followed by personal loans from family or friends (17.4 percent), venture capitalist (6.52 percent) and asset-based finance in the form of leasing (2.17 percent). The majority of respondents are being charged with low audit fees that are at least 0.5 percent or lesser against the companies' turnover. This indicates that audit fees in Malaysia are still considered low and hardly a financial burden to SMEs. The result is in line with findings by ICPAS, (2000) where they found that audit fees generally represent up to 0.5 percent of turnover for most companies and therefore cannot be considered a financial burden. Based on the demographic profile, the number of respondents for this study is largely represented by wholly family-owned business (67.4 percent) instead of partly family-owned business (32.6 percent). Most SME companies in the world are owned by families which account for almost two third of a

country's business (Holan and Sanz, 2006) and offer competitive advantage over non-family business. As the result showed that the respondents mostly came from owner-managed companies, it indicates that the survey has met its target respondents as the study is aimed to explore the opinions of SMEs' directors who are responsible to weigh up the costs and benefits before opting for audit exemption. In terms of director's qualification, the majority of the respondents (88.2 percent) were qualified and had at least a certificate, a degree, a master degree and/or equipped with professional educations. Both the position and qualification profile of the respondents suggest that they would have both tacit and formal knowledge which enable them to weigh up the costs and benefits of the audit and qualify to answer the questionnaire as established by Collis, (2003). A majority of the respondents revealed that they do not have any future plans to expand their business. 76.1 percent of the respondents do not have any plans to be listed in the stock exchange and 87 percent of them do not plan to sell the business in the future.

Based on the analysis, it was revealed that the majority of respondents (69.6 percent) chose to continue to have their financial statements audited even if there are no statutory requirement to do so, as opposed to 30.4 percent of respondents who chose to discontinue audit services if they were given the option for audit exemption. These results signify a low take-up level of audit exemption among SMEs and may be attributed to the realization among SMEs with regards to audit values and benefits. Such results contradict Collis' (2003) survey in the UK where the majority of respondents (56 percent) said that they would discontinue the audit while the rest of the respondents would have the accounts audited on a voluntary basis. The main reasons given by those who would opt for audit exemption were that there would be no benefit in having the accounts audited or that there would be cost savings from discontinuing the audit.

**Statistical test**

This section provides tests of H<sub>1</sub> to H<sub>7</sub> using multiple regression analysis. Multiple regression analysis is used in explaining the effects of the value of an audit, financing strategy, future plan, size of firm, director's qualification, dependent users and audit cost towards the take-up level of audit exemption among SMEs in Malaysia. To establish the independence of the two groups in the dependent variable (AUD\_EXEMPT) and each independent variable measured on a non-parametric ordinal scale (AUD\_VAL, SIZE, DEPENDENT, AUD\_COST), Mann-Whitney tests of difference were conducted. The low values of the probability statistics in Table-1 provide evidence of a significant difference between the two groups in each test (p<0.05) and therefore these independent variables are included in the regression model. Chi-square tests were then used to measure the association between the two groups in the dependent variable (AUD\_EXEMPT) and each of the independent variable measured on a nominal scale (FUTURE and DIR\_QUAL).

**Table-1.** Demand for Audit Exemption: Mann-Whitney Test

Variable	AUD_EXEMPT	Mean rank	Sum of ranks	Mann-Whitney U	Wilcoxon W	Z	p
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AUD_VAL	1 Yes	39.50	79.00	12.00	1002.00	2.162	0.031
	2 No	22.77	1002.00				
SIZE	1 Yes	23.38	917.8	128.8	118.8	1.872	0.000
	2 No	18.42	118.8				
DEPENDENT	1 Yes	34.50	73.12	96.8	987.6	0.673	0.000
	2 No	20.55	987.60				
AUDIT COST	1 Yes	24.17	942.50	110.50	138.50	0.997	0.000
	2 No	19.79	138.50				

**Table-2.** Demand for Audit Exemption: Chi-square Test

Variable	AUD_EXEMPT	Chi-square	df	p
FINANCE	1 Yes	13.136	1	0.000
	2 No			
FUTURE	1 Yes	17.406	1	0.000
	2 No			
DIR_QUAL	1 Yes	11.182	1	0.000
	2 No			

**Table-3.** Regression Results

Variables	Coefficients	Std. Error	t-stat	p-value	VIF
Constant		0.130	5.331	0.000	
AUD_VAL	-0.416	0.055	3.896	0.000	2.700
FINANCE	-0.287	0.070	2.665	0.008	2.813
FUTURE	-0.243	0.050	2.265	0.025	2.175
SIZE	-0.123	0.100	4.045	0.000	2.150
DIR_QUAL	-0.123	0.120	1.876	0.158	1.182
DEPENDENT	-0.123	0.080	2.715	0.001	2.123
AUD_COST	0.196	0.024	2.109	0.036	1.278
	R	=	0.315		
	R <sup>2</sup> (Adjusted R <sup>2</sup> )	=	0.208 (0.208)		
	F-statistic (p-value)	=	10.252 (0.000)		
	Durbin Watson statistic	=	1.350		

\*Significant at 1% level

The probability statistics shown in Table-2 provide evidence of a significant positive association between the two groups in the dependent variable (AUD\_EXEMPT) and the categories in the independent variables FINANCE, FUTURE and DIR\_QUAL (p<0.05). Therefore, these three

variables can be included in the regression model. Table-3 shows that the probability statistics for all variables are significant ( $p < 0.05$ ) except for DIR\_QUAL. Moreover, the factor coefficients for these variables indicate the expected negative relationship with the take-up level of audit exemption while the factor coefficient for AUD\_COST indicates the expected positive relationship with the dependent variable. Therefore, there is evidence to accept all six hypotheses except for  $H_5$ . The  $R^2$  indicates that the independent variables in the regression model explain 20.8 percent of the demand for audit exemption.

SMEs that perceived a high value of audit are more likely to continue to have their financial statements audited even though they are not legally obliged to do so. These SMEs may have realized that audit brings important benefits to the company despite having to pay audit fees. Since  $H_1$  is accepted, the study concludes that the value of audit significantly influence the decision of SMEs whether to continue or discontinue having audited financial statements. This is consistent with Collis (2003) who found that the audit values are associated with SMEs decision to opt for voluntary audit. However in the survey, a majority of respondents chose to discontinue audit if they believe there would be no benefits or values of having audit. SMEs that have the intention to apply or extend their loans and financing may need to present financial statements to the banks or other lenders to assess the credit worthiness of the company. Furthermore, these financial institutions may demand the financial statements to be audited before they can rely on them since the audited financial statements are the best assurance they have of the company's financial status (Taurigana and Clarke, 2000). Such reasoning may influence the SMEs decision to take on audit exemption because they may need to have additional financing to expand their business in the future; thus explaining the argument for accepting the second hypothesis. According to ICPAS (2000), companies with the intention to be listed in a stock exchange or intend to secure financing or credit from lenders may find audit exemption to be unappealing due to the need to prepare the audited accounts in the future. Companies that are expanding also may view the audit exemption as less attractive because once their turnover exceeds the audit exemption requirement, then they would be required to prepare the audited accounts which will cost the company more money. With this reasoning,  $H_3$  is supported and accepted.

The study found that the size of firms will significantly influence the take-up level of audit exemption among SMEs in Malaysia. This can be attributed to the fact that one of the requirements for companies to be eligible for audit exemption is that their turnover must not exceed the required turnover as stated by the audit exemption thresholds. When their turnover exceeds the thresholds, they will need to have their accounts audited. Such argument is supported by Kenny (2005) and Bartram, (2004). They respectively view that growing companies may find audit exemption less attractive as once the turnover threshold is exceeded, they would no longer be eligible for the exemption and the larger the company, the less likely it is to seek exemption. Hence,  $H_4$  is supported.

Directors who are well educated and highly qualified in business and management disciplines are more likely to appreciate the value of an audit. Collis (2001) as cited in Collis (2003) finds that qualified directors acknowledged the practical benefits of voluntary audit exceed the costs of conducting an audit. However, this does not mean that their knowledge and education will influence their decision to choose for audit exemption as depicted in our regression result that showed director's qualification do not significantly influence the take-up level of audit exemption. Since the main users of the accounts are the directors themselves, they are more likely to look forward to having any alternative that can enable them to save the company's money; namely audit exemption. Hence, there may not be a need for an external audit and with that,  $H_5$  is rejected.

Davies (2004) reports that the biggest criticism of the legal necessity for the audit usually comes from very small companies in which the directors and shareholders are one and the same. Due to this, one may not see the relevance of having audited financial statements since the financial reports will be reviewed by the same person who prepared them. However, there are occasions where shareholders and other stakeholders will request to review the financial statements before making decision in regards to the company's financial affairs. Banks or other lenders invariably require audited accounts as evidence to base their lending decisions. Traditionally, the Inland Revenue Board (IRB) has also used audited accounts as a basis for determination of tax liability (Davies, 2004). With this reasoning, the study concludes that the dependent users will significantly influence the SMEs' decision to take on audit exemption if it is made available for small companies in Malaysia and  $H_6$  is accepted. As depicted in Table-3, audit costs have a positively significant relationship with the take-up level of audit exemption and therefore,  $H_7$  is supported. As audit exemption may save SMEs from having to pay for audit fees, SMEs will be more likely to be attracted to choose audit exemption over audit. This is because audit exemption offers cost savings. However, according to ICPAS (2000), audit cannot be deemed as costly because from their survey, they found that the audit fee generally represents up to 0.5 percent of the company's turnover and therefore cannot be considered as a financial burden.

## **CONCLUDING REMARKS**

In recent years, many countries have granted small companies exemption from statutory audit such as the UK, USA, Australia and Singapore. The main motivation to opt for audit exemption is that an audit is costly and burdensome. Removing the need for an audit can reduce costs and save management time in preparing their annual accounts. However, this is contradicted with a survey finding by ICPAS in 2000 where they found that the audit fee generally represents only up to 0.5 percent of turnover for most companies and therefore cannot be considered a financial burden to companies. Significantly, most SMEs in Malaysia are small companies in which the directors and shareholders are one and the same. Therefore, the benefits of having an audit may not be relevant

since shareholders who also are the directors of the company would essentially be reporting to themselves about the accounts that they already knew and prepared themselves. Other studies also indicated the irrelevance of having an audit for owner-managed companies and therefore, the audit check on directors' trusteeship is not needed (ICPAS, 2000; Tabone and Baldacchino, 2003; Davies, 2004). Nevertheless, audit is still an important tool to identify the existence of fraud and to assess the adequacy of the company's internal controls (Davies, 2004).

This study was conducted to achieve two objectives. The first objective is to examine the perceptions of small and medium-sized companies (SMEs) towards the value of audit and audit exemption. Based on the findings of the study, it shows that there is a low take-up level of audit exemption among SMEs in Malaysia. Companies that have chosen to continue with statutory audit cited the reason being it will be beneficial for them in the future and audit helps to increase transparency and accountability of the company. The results contradicted with Collis (2003) survey in the UK where the majority of respondents predict that they would discontinue the audit while the rest of the respondents predict that they would have the accounts audited on a voluntary basis. The main reasons given by those who would opt for audit exemption were that there would be no benefit in having the accounts audited or that there would be cost savings from discontinuing the audit.

The study initially hypothesized that factors such as the value of audit, financing strategy, future plans, size of firms, director's qualification, dependent users and audit cost will have a significant influence towards the take-up level of audit exemption among SMEs in Malaysia. The overall results showed that all of these factors significantly influence the take-up level of audit exemption with the exception of director's qualification factor. The result of this study is almost similar to Collis (2003). Collis (2003) also found that the size of firms and dependent users significantly have influence towards the acceptance of audit exemption. This study thus is able to meet its second objective, which is to determine the factors that will influence the take-up level of SMEs among SMEs in Malaysia. Some of these results can contribute to the culture on accounting and auditing practices in Malaysia as mentioned by Haniffa (2006). Ali et al. (2006) further conclude that auditing in Malaysia is not just a technical phenomenon but one intertwined with the dynamics of the wider political and socio-economic context. This is because the practice of audit in Malaysia was merely to fulfill legal requirements as lined out in the Companies Act 1965 and provide an image of modern economy to attract investments instead of to address the needs of its own social environment; to protect the interest of shareholders and provide accurate information to the public. As a result, the study can use the same conclusion made by Dennehy (2004) in which audit exemption can undoubtedly be attractive to certain SMEs, especially those which have consistently low turnover, are self-financing and are closely managed by shareholders. Additionally, Dennehy (2004) also acknowledged the attraction of audit exemption has been either to dormant companies or those with consistently low income. This is consistent with the issue of audit exemption in

regards to credit granting and stewardship of the statutory accounts. The problem now is not whether an audit is desirable or valuable for companies, and smaller companies in particular, but whether the balance of costs and benefits of having an audit will bring some advantages to the company. Depending on how SMEs viewed the value on audit and audit exemption, SMEs will have to weigh the advantages and disadvantages of having being audited or availing themselves of the audit exemption before making decisions.

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