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A Consultative Document

On Creating a Conducive Legal and Regulatory Framework for Businesses

by the Corporate Law Reform Committee
for the Companies Commission of Malaysia

SURUHANJAYA SYARIKAT MALAYSIA
COMPANIES COMMISSION OF MALAYSIA

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COMPANY LAW

CORPORATE LAW REFORM COMMITTEE

A CONSULTATIVE DOCUMENT CREATING A CONDUCIVE LEGAL AND REGULATORY FRAMEWORK FOR BUSINESSES

JANUARY 2007

The Corporate Law Reform Committee invites comments, by **15 April 2007** on the issues set out in this Consultative Document.

You are invited to send comments, together with any supporting evidence on any part of this consultation. We would be grateful if you could refer to the recommendation number(s) and/or paragraph number(s) in your feedback, preferably by email, to:

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Confidentiality: Your responses may be made public by the CLRC. If you do not want all or part of your response or name made public, please state this clearly in the response. Any confidentiality disclaimer that may be generated by your organisation's IT system or included as a general statement in your fax cover sheet will be taken to apply only if you request that the information remain confidential.

Section A
Foreword

SECTION A - FOREWORD

One of the core objectives of the Corporate Law Reform Programme is to make the law and regulations conducive to business.

The Corporate Law Reform Committee (CLRC), through its Working Group A, reviewed the existing law and regulations to find out how it could be simplified and how to lessen the administrative and compliance burden on companies. Particular attention was paid to the needs of small businesses, who can least afford to comply.

The CLRC examined whether there should be separate legislation for small companies, whether the distinction between private and public companies should be removed, and the ability of private companies to raise capital from the public.

The question of whether an audit of a company's accounts should remain mandatory was also looked into. In arriving at its recommendations, the CLRC considered representations made by representatives of the accounting community and commissioned a survey of the company directors of small and medium sized enterprises (SMEs) to find out their views. The results of this survey are set out in Section D to this Consultative Document.

At present, companies must appoint professional secretaries. The CLRC looked at whether this should remain mandatory.

The enforceability of contracts is of importance to business and so the capacity of a company to contract and the doctrine of constructive notice were reviewed.

Company formation and the filings that currently have to be made with the Registrar were also reviewed. The CLRC looked at the types of companies that can be incorporated, single member companies, the incorporation process from name search and reservation to certificate of incorporation, electronic filing and the liability of the Registrar.

As with other Consultative Documents, the review process comprised initial discussions and compilations of views from the members of Working Group A which resulted in a Recommendation Paper. This Recommendation Paper was then presented to the Technical Sub-Committee (TSC) of the CLRC for further deliberations. The TSC comprises the Chairman of the CLRC, the Chairmen and Deputy Chairmen of each Working Group and the representative(s) from Bursa Malaysia Securities Berhad. Upon the endorsement from the TSC, the paper was presented to the CLRC for approval prior to being published for public consultation.

We hope to receive views and comments on the recommendations stated in this Consultative Document. Please reply to Nor Azimah Abdul Aziz at the Companies Commission of Malaysia (SSM) by **15 April 2007**.

Thank you

Yours truly,

Dato' K.C Vohrah
Chairman
Corporate Law Reform Committee

Charon Wardini Mokhzani
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Section B
Executive Summary

SECTION B - EXECUTIVE SUMMARY

1.0 BACKGROUND

1.1 This Consultative Document explains the views of the CLRC in relation to the proposed changes to the Companies Act 1965 with the objectives of simplifying the laws and procedures for companies generally and small companies in particular.

1.2 This Consultative Document focuses on:

(a) separate legislation for small companies;
(b) the distinction between private and public companies;
(c) the ability of private companies to raise capital;
(d) audits, financial reporting and disclosure;
(e) company secretaries;
(f) the capacity of a company to contract and constructive notice; and
(g) company formation and related matters.

2.0 SEPARATE LEGISLATION FOR SMALL COMPANIES

2.1 In considering whether there is a need to have separate legislation to cater to the needs of 'small' companies, the CLRC believes an integrated approach would better facilitate the growth and natural progression of companies. At the same time, the CLRC acknowledges that there should be simplification of laws and procedures, particularly for 'small' companies.

2.2 The CLRC recommends that there should be a single statute that will apply to companies irrespective of whether the company is small or large (in terms of ownership structure or economic size etc.), and that there is a need to simplify and refine company legislation to ease the burden of compliance on small and closely held companies.

3.0 THE DISTINCTION BETWEEN PRIVATE AND PUBLIC COMPANIES

3.1 The CLRC recommends that the distinction between public and private companies be kept and that this be used as a basis in simplifying and making company law more conducive to business.

4.0 THE ABILITY OF PRIVATE COMPANIES TO RAISE CAPITAL

4.1 The CLRC recommends that a private company should be defined as one where:

(a) the number of its members cannot exceed 50;
(b) the Articles of Association restrict the right of its members to transfer their shares; and
(c) an offer or issues of its shares (but not debentures) cannot be made to the public.

5.0 AUDITS, FINANCIAL REPORTING AND DISCLOSURE

5.1 The CLRC recommends the retention of the present statutory requirements in relation to accounting records and financial reporting.

5.2 Whilst the CLRC understands the importance of auditing company accounts in promoting accountability, accuracy and transparency, there is also a need to examine the value and necessity of audit in providing a balance between the needs of the company and that of public interests. In this regard, the CLRC seeks views on the better alternative between the following two options:

(i) that audit should be mandatory for all types of companies, or

(ii) that there should be an exemption from the audit requirement for certain categories of companies.

6.0 COMPANY SECRETARIES

6.1 The CLRC recognises the importance of the role played by company secretaries in ensuring that companies comply with the relevant laws and regulations. Therefore, the CLRC recommends the retention of the mandatory appointment of company secretaries for all companies.

7.0 THE CAPACITY OF A COMPANY TO CONTRACT AND CONSTRUCTIVE NOTICE

7.1 The CLRC recommends that newly formed companies should, unless the company otherwise elect, have unlimited capacity and a transitional period be given to existing companies to alter their Memorandum of Association to have unlimited capacity.

7.2 The CLRC recommends that the doctrine of *ultra vires* be abolished as it applies to third parties but retained only in so far as it applies to members of the company and in proceedings by members against any director or former director as well as any petition by the Minister to wind up the company as is currently found in section 20 of the Companies Act 1965.

7.3 To complement the abolition of the *ultra vires* doctrine, the CLRC recommends that the doctrine of constructive notice be abolished except in its application to company charges.

8.0 COMPANY FORMATION AND RELATED MATTERS

A. TYPES OF COMPANIES THAT CAN BE INCORPORATED

8.1 The CLRC believes that the present classification of companies according to the liability of members is sufficient and recommends its retention.

B. MINIMUM NUMBER OF MEMBERS AND DIRECTORS

8.2 The CLRC recommends that the law allow for the formation of a single-member company.

8.3 The CLRC also recommends that a company be allowed to have a single director who is a natural person of full age.

8.4 The CLRC also recommends the retention of the residency requirement for directors.

C. INCORPORATION AND REGISTRATION OF COMPANIES

THE NAME SEARCH AND RESERVATION PROCESS

8.5 The CLRC recommends that in approving or refusing a name for the purposes of reservation, there should be clear provisions in the Companies Act 1965 to exonerate the Registrar from liability for any loss or damage suffered.

8.6 The CLRC recommends that the name reservation process should not be made mandatory. Further, in the event a name is reserved, the name reservation period should be shortened. In addition, the register of reserved names should be accessible to the public.

SIMPLIFICATION OF THE INCORPORATION PROCESS

8.7 The CLRC recommends that to simplify the incorporation process, an incorporation document in a prescribed form should be introduced.

STATUTORY DECLARATIONS

8.8 The CLRC recommends that the requirement to lodge a statutory declaration be replaced with the requirement to lodge a statement of compliance.

CERTIFICATES OF INCORPORATION

8.9 The CLRC recommends the retention of the issuance of certificates of incorporation to identify and evidence the formation of companies.

COMPANY SEALS

8.10 The CLRC recommends the retention of the requirement for companies to have a common seal as it still has significance in the companies' day-to-day operations in view of the requirements of other laws.

D. FACILITATING ELECTRONIC INCORPORATION AND ELECTRONIC FILING/LODGEMENT OF DOCUMENTS

ELECTRONIC FILING AS AN ALTERNATIVE TO PAPER FILING

8.11 The CLRC recommends that a hybrid process for the filing of documents be adopted allowing subscribers of the e-filing service to lodge documents electronically whilst those who have not chosen to be subscribers can still utilise the paper filing system.

SIGNATURE AND ATTESTATION OF WITNESSES

8.12 The CLRC recommends that documents signed electronically need not be attested.

REGISTRAR TO UTILISE ELECTRONIC SERVICES

8.13 The CLRC recommends that section 11A of the Companies Act 1965 be amended to allow the Registrar to utilise the electronic services including in the issuance of orders, notices, certificates and others to users.

8.14 Accordingly, the CLRC recommends that the definition of 'documents' under section 4(1) of the Companies Act 1965 be amended to include the electronic issuance of orders, notices, certificates, etc.

RE-LODGEMENT OF LOST DOCUMENTS

8.15 The CLRC recommends that upon the lodgement of documents *via* electronic means, the person lodging the document must keep a copy of the document and this must be made available to the Registrar when required.

LIABILITY OF REGISTRAR

8.16 The CLRC recommends the retention of the present section 11A(8) of the Companies Act 1965 that provides protection to the Registrar against any loss or damage suffered by any person resulting from errors or omissions appearing in the documents obtained, if such documents were electronically filed or lodged.

Section C

Creating a Conducive Legal and Regulatory Framework for Businesses

SECTION C - CREATING A CONDUCIVE LEGAL AND REGULATORY FRAMEWORK FOR BUSINESSES

1.0 BACKGROUND

1.1 The objectives of the Corporate Law Reform Programme in Malaysia, as stated in the *Strategic Framework for the Corporate Law Reform Programme of the Companies Commission of Malaysia,* are to create a legal and regulatory structure that facilitates business, whilst ensuring the accountability and corporate governance of corporate participants, in line with international standards.

1.2 This Consultative Document explains the views of the Corporate Law Reform Committee (CLRC) in relation to the changes to the Companies Act 1965 that will simplify the laws and procedures for companies generally and 'small' companies in particular. This document also seeks to obtain feedback on the appropriate approach to facilitate business growth through the reduction of administration and compliance costs.

1.3 This document consists of deliberations in relation to:

- whether the current legislation meets the needs of companies, in particular small companies, and the extent to which the legislation meets such needs;
- whether an audit of a company's accounts should remain mandatory;
- disclosure and financial reporting obligations;
- the requirement for company secretaries; and
- simplifying laws and procedures to facilitate carrying on business as a company.

2.0 SEPARATE LEGISLATION FOR SMALL COMPANIES

2.1 The CLRC recognises that the blanket application of companies' legislation to all companies, regardless of size and structure, imposes burdens on 'small' companies.

2.2 A company may be regarded as 'small' either due to the small number of its members or its economic size. Where the number of members is small, the members are usually involved in the management of the company. These companies are usually referred to as 'closely-held companies' although they are not necessarily small in terms of economic size. In this Consultative Document, the CLRC is concerned with the needs of small companies, identified as such by the number of their members as well as their economic size.

2.3 The CLRC is of the view that company law should be simple, accessible and responsive to the needs of businesses, particularly small companies.

2.4 The CLRC examines the following issues as the backdrop to its review:

- Whether there should be a single statute that will apply to companies irrespective of whether the company is small or large; and
- Whether there is a need to simplify and refine company legislation to ease the burden of compliance on small and closely-held companies.

THE NEED FOR A SINGLE COMPANY STATUTE

2.5 The CLRC acknowledges that small companies play a vital part in economic growth. These companies may find the requirements under the Companies Act 1965 burdensome, overwhelming and even costly.

2.6 The CLRC considered the view that it might be easier for small companies to be governed under a separate piece of legislation which would be able to cater to their specific needs.[1] However, it also noted that once these companies develop beyond the boundaries of the qualifying criteria set under the separate legislation, they would have to revert to the Companies Act regime.

2.7 The CLRC believes that a single Companies Act will better facilitate business growth and promote a company's natural business progression from small to large without the unnecessary costs of reincorporation.[2]

2.8 In addition, the CLRC believes that this will also avoid transitional problems for small companies wanting to expand either in terms of its number of members (for example by going public) or in terms of business operations. Separate legislation for small companies may create a trap for small companies in the event that they have ceased to satisfy the criteria for being 'small' and yet have failed to take the necessary steps to convert[3] once they become 'large' companies.

THE NEED FOR THE SIMPLIFICATION AND REFINEMENT OF LAW

2.9 On the basis that there should be a single companies statute, the CLRC believes that there should be a simplification of company law for small companies in the following areas:

(i) Governance structure, and

(ii) Auditing, accounting and financial reporting.

[1] As an example, the Close Corporations Act 1984 (South Africa) allows companies with not more than 10 members to be incorporated under it. The Act also simplifies laws on meetings, disclosure and reporting obligations.

[2] UK Company Law Review Modern Company Law for a Competitive Economy: Final Report, Ch 2 June 2001; see also Company Law Review, Modern Company Law for a Competitive Economy: Developing the Framework, Ch 6, 1999.

[3] Ibid.

2.10 It has been noted by the CLRC that where governance structure is concerned, the current regulatory structure does not acknowledge that there are notable distinctions in the structure of companies. In relation to governance and ownership structure, there are:

- companies where all the members are actively involved in the management of the company and where the board of directors comprises the members themselves. These are often referred to as closely held companies;[4]
- companies where only some of the members are members of the board of directors;
- companies which are wholly-owned subsidiaries of other companies;
- companies which are joint-venture companies: where all members are actively involved in the management of the company by being members of the board of directors or where only some of the members are actively involved in management.

2.11 The CLRC acknowledges that often in small and closely held companies, the concern about the need to monitor directors and management arising out of the separation between ownership and control may not occur because of the fact that owners are also managers. There is often equal access to and availability of information for all members to enable them to assess the state of the company's affairs and to make decisions based on the available information. Nonetheless, such companies must still comply with the procedures and statutory requirements of the Companies Act 1965. In practice, these requirements are often not stringently adhered to, especially in relation to meetings and disclosure.

[4] Closely held companies are usually small in membership structure but not necessarily small in economic size.

2.12 Where reports and accounts are concerned, the financial reporting and obligations on disclosure are meant to ensure the transparency of corporate information for members and the public, mainly creditors who rely on the information in their dealings with the company. However, there are valid concerns that the present provisions in the Companies Act 1965 pose undue regulatory and administrative burdens to small and closely held companies. The information in these companies is of limited use or value to the public because the companies are normally self-funded and do not rely on external financing. There is often active involvement in management by all members. However, there is still a need to ensure the protection of members who are not involved in management and creditors' interests.

RECOMMENDATIONS

2.13 The CLRC recommends that:

(i) there should be a single statute that will apply to companies irrespective of whether the company is small or large (in terms of ownership structure or economic size etc.); and

(ii) there is a need to simplify and refine company legislation to ease the burden of compliance on small and closely held companies.

Question for Consultation:

Question 1:

Do you agree that:

(i) there should be a single statute that will apply to companies irrespective of whether the company is small or large; and

(ii) there is a need to simplify and refine company legislation to ease the burden of compliance on small and closely held companies?

3.0 THE DISTINCTION BETWEEN PRIVATE AND PUBLIC COMPANIES

3.1 The Companies Act 1965 classifies companies based on liability of their members, as follows:

(a) companies limited by shares;

(b) companies limited by guarantee; and

(c) unlimited companies.[5]

3.2 The overwhelming majority[6] of companies established under the Companies Act 1965 are companies limited by shares,[7] and these are divided into private companies and public companies. The Companies Act 1965 defines a private company as one which is restricted in:

(a) the number of members it can have;

(b) raising capital from the public;[8] and

(c) the transferability of its shares.

3.3 The Companies Act 1965 also provides for a class of private companies known as 'exempt private companies'.[9] These are private companies that only have natural persons as members.

[5] With effect from 1 February 1986, the Companies Act 1965 prohibits new companies to be incorporated as a company limited both by shares and guarantee by virtue of section 14A.
[6] 99.88% as at June 2006.
[7] A company limited by shares is registered on the principle that members' liabilities are limited by the Memorandum and Articles of Association to the amount of any unpaid consideration on shares taken up by them.
[8] Section 15(1) of the Companies Act 1965.
[9] See definition under section 4(1) of the Companies Act 1965.

3.4 All companies limited by shares which are not private companies are public companies.

3.5 The decision whether to be a private or public company has to be made when incorporating the company. The decision affects the company, as public and private companies are treated differently, as explained below:

(a) *Fund raising*

Public companies can raise debt and equity capital from the public. Private companies however cannot issue shares or debentures to the public. Public companies which are listed on Bursa Malaysia can in certain circumstances buy-back their shares: private companies cannot.[10]

(b) *Governance*

There are governance provisions which only apply to public companies, such as: they must hold a first a first statutory meeting,[11] there restrictions on them having directors who are more than 70 years old;[12] the holder of equity shares[13] in public companies or in a subsidiary of a public company must be entitled to exercise their rights at a poll at a general meeting.[14] While private and public companies are prohibited from providing loans to directors, exempt private companies are allowed to do so.[15]

[10] See section 67A of the Companies Act 1965.
[11] See section 142 of the Companies Act 1965.
[12] See section 128 of the Companies Act 1965.
[13] Section 4(1) defines equity shares as 'any share which is not a preference share'.
[14] See section 55 of the Companies Act 1965.
[15] See sections 133 and 133A of the Companies Act 1965.

(c) *Financial reporting*

All companies are required to keep and maintain accounts and to have those accounts audited. They must also make those accounts public by filing their audited accounts together with their annual returns with the Registrar.[16] Exempt private companies however do not have to file their audited accounts with the Registrar.

3.6 The CLRC considered whether the current distinction between private and public companies helps small businesses and closely-held companies. The CLRC accepted that the regulations which apply to a large business enterprise where there is a separation between those who manage and control the business and the owners of the shares may not be applicable to a small business where the shareholders actively manage the business. Similarly, a closely-held large company may have to be regulated differently than a small one.

3.7 Under the existing system, a private company can be very large in economic terms, with many employees and trade and other creditors, and yet be allowed to lend money to its directors and not make its accounts public; whereas another private company, much smaller in economic terms, cannot. A small family business operating as a private company has the same statutory financial reporting requirements as the largest companies listed on Bursa Malaysia.

3.8 The CLRC therefore considered doing away with the distinction between public and private companies altogether (as has been done in New Zealand, and is the case for the Offshore Companies Act 1990). In its place, the CLRC considered having different fund raising, governance and financial reporting requirements for

[16] See section 165A and the Eighth Schedule of the Companies Act 1965.

companies depending on their economic size and the number and types of members they have. When a company reached a certain economic size or when its shareholders became numerous and separate from management, then different regulations would apply.

3.9 The CLRC finally decided not to pursue this radical approach. The distinction between private and public companies is entrenched, both in legislation (even those which do not directly deal with company matters) and in business. Implementing a gradated series of requirements on companies based on their economic size or shareholdings would also be difficult. How could SSM monitor when a company reached a certain size and so had to comply with different regulations? Could we just depend on companies to voluntarily comply? What would the thresholds be? Should the criteria used by other government agencies in defining small and medium sized enterprises (SMEs)[17] be adopted or should it be some other measure?

3.10 The CLRC instead proposes that the fund raising, governance, financial reporting and other requirements be looked at separately and they be reformed (if necessary) to simplify and make company law more conducive to business, especially for SMEs. In doing so, the CLRC looked at balancing the need for private enterprise to be entrepreneurial and to keep their financial affairs confidential and the public interest in regulating their conduct or requiring disclosure of their financial affairs.

[17] Small and Medium Industries Development Corporation (SMIDEC) divides SMEs into two broad categories: 'manufacturing' and 'services'. Under the 'manufacturing' category, a small enterprise is one whose revenue is between RM250,000 and less than RM10million or whose full time employees are between 5 and 50; whereas a medium enterprise is one whose revenue is between RM10million and RM25million or whose full time employees are between 51 and 150. Under the 'services' category, a small enterprise is one whose revenue is between RM200,000 and less than RM1million or whose full time employees are between 5 and 19; whereas a medium enterprise is one whose revenue is between RM1million and RM5million or whose full time employees are between 20 and 50.

RECOMMENDATION:

3.11 The CLRC recommends that the distinction between public and private companies be kept and that this be used as a basis in simplifying and making company law more conducive to business.

Question for Consultation:

Question 2:
Do you agree that the distinction between public and private companies should be kept and that this should be used as a basis in simplifying and making company law more conducive to business?

4.0 THE ABILITY OF PRIVATE COMPANIES TO RAISE CAPITAL

4.1 As noted earlier, the Companies Act 1965 defines a private company as one which is restricted in:
(a) the number of members it can have;
(b) raising capital from the public; and
(c) the transferability of its shares.
Companies limited by shares which are not private companies are public companies.

4.2 The hallmark of a private company is that it has a limited number of members. The CLRC notes that comparable jurisdictions all maintain this feature. This means that private companies cannot raise capital by issuing shares to the general public, as that would mean they would no longer have a limited number of members.

4.3 The CLRC accepts this. However, it considered whether a private company should be allowed to raise capital in the form of debentures from the public. This would allow private companies access to a wider pool of capital. If this were permitted, investors who bought the debentures would be protected as the Securities Commission regulates the issue of debentures and there are extensive laws and regulations on this subject.

4.4 Comparable jurisdictions no longer define private companies by their ability to raise capital from the public. Many of them however, still prohibit private companies from raising capital from the public, whether in the form of shares or debentures.

4.5 Under the Australian Corporations Act 2001, a proprietary (private) company is defined by reference to the limitation on the number of members where the company cannot have more than 50 non-employees as its members.[18] Although there is no express provision that a proprietary company cannot raise capital from the public, a proprietary company is prohibited from engaging in any activity that would require disclosure to investors, except for an offer of its shares to existing shareholders of the company; or employees of the company or of a subsidiary of the company.[19] The Corporations Act 2001 clearly states that any fundraising from the public requires a disclosure document and at the same time provides a list of exemptions where fundraising by a company does not require a disclosure document.[20]

[18] Section 113(1) of the Corporations Act 2001.
[19] Section 113(3) of the Corporations Act 2001.
[20] Section 708 of the Australian Corporations Act 2001 generally outlines that a disclosure requirement is not required when:

- an offer is a personal offer, and if:
  - offers or invitations have been made to fewer than 20 persons in the previous 12 months, and
  - the new offer will not result in more than $2 million being raised in that 12 months;
- the offers are made to specified people who are presumed not to need disclosure because of their financial capacity, experience, or wholesale status;
- the offers are made to current holders of the securities;
- no money or other form of payment is payable for the securities;
- other disclosure regimes under the Corporations Act apply (i.e. takeovers, schemes of arrangement);
- the offer is made by certain types of financial institutions.

4.6 In the UK, the Company Law Review recommended that:

- company law should continue to prohibit private companies from offering their shares to the public;
- the meaning of 'offer to the public' for the purposes of that prohibition (and in particular, the related exemptions) should be aligned as far as possible with the exemptions which apply in relation to an offer to the public for the purposes of securities regulation; and
- private companies should be prohibited from admitting their shares to trading on a prescribed investment exchange, or from assisting in any way an application for admission of their shares to trading made by any other person.

These recommendations have been endorsed by the UK Government.[21]

4.7 To effect the above recommendations, the UK Companies Bill 2006 makes it clear that a private company is prohibited from offering to the public any securities of the company.[22] At the same time, section 769 of the Bill also introduces the meaning of 'an offer to the public' in relation to restriction on public offers by private companies as follows:

[21] Department of Trade and Industry, UK, White Paper on 'Company Law Reform', March 2005 at para 4.11; see section 768 of the Companies Bill.

[22] Section 768 of the UK Companies Bill (Bill 218 2005-06) as of July 2006 (which was originally section 529 of the UK Company Law Reform Bill) states the prohibition of public offers by private company as follows:

(1) A private company limited by shares or limited by guarantee and having a share capital must not—

(a) offer to the public any securities of the company, or

(b) allot or agree to allot any securities of the company with a view to their being offered to the public.

(2) Unless the contrary is proved, an allotment or agreement to allot securities is presumed to be made with a view to their being offered to the public if an offer of the securities (or any of them) to the public is made—

(a) within six months after the allotment or agreement to allot, or

(b) before the receipt by the company of the whole of the consideration to be received by it in respect of the securities.

(3) A company does not contravene this section if—

(a) it acts in good faith in pursuance of arrangements under which it is to re-register as a public company before the securities are allotted, or

(b) as part of the terms of the offer it undertakes to re-register as a public company within a specified period, and that undertaking is complied with.

(4) The specified period for the purposes of subsection (3)(b) must be a period ending not later than six months after the day on which the offer is made (or, in the case of an offer made on different days, first made).

(5) In this Chapter 'securities' means shares or debentures.

'(1) This section explains what is meant in this Chapter by an offer of securities to the public.

(2) An offer to the public includes an offer to any section of the public, however selected.

(3) An offer is not regarded as an offer to the public if it can properly be regarded, in all the circumstances, as—

(a) not being calculated to result, directly or indirectly, in securities of the company becoming available to persons other than those receiving the offer, or

(b) otherwise being a private concern of the person receiving it and the person making it.

(4) An offer is to be regarded (unless the contrary is proved) as being a private concern of the person receiving it and the person making it if—

(a) it is made only to persons already connected with the company and, where it is made on terms allowing that person to renounce his rights, the rights may only be renounced in favour of another already connected with the company; or

(b) it is an offer to subscribe for securities to be held under an employees' share scheme and, where it is made on terms allowing that person to renounce his rights, the rights may only be renounced in favour of—

(i) another person entitled to hold securities under the scheme, or

(ii) a person already connected with the company.

(5) For the purposes of this section 'person already connected with the company' means—

(a) an existing member or employee of the company,

(b) a member of the family of a person who is or was a member or employee of the company,

(c) the widow or widower, or surviving civil partner, of a person who was a member or employee of the company,

(d) an existing debenture holder of the company, or

(e) a trustee (acting in his capacity as such) of a trust of which the principal beneficiary is a person within any of paragraphs (a) to (d).

(6) For the purposes of subsection (5)(b) the members of a person's family are the person's spouse or civil partner and children (including step-children) and their descendants.'

4.8 The CLRC also noted that the Singapore Company Legislation and Regulatory Framework Committee (CLRFC) recommended that for incorporation purposes, the current definition of a private company[23] be amended by deleting the current restriction that a private company cannot raise capital, either equity or debt, from the public. This was to rationalise the structure of the company legislation in view of the CLRFC's recommendation to regulate public offerings of securities through a regime of public and exempted offerings.[24]

4.9 The CLRC noted that there are views that the Singapore approach is suitable for Malaysia since the law in relation to the offering of securities (i.e. issue of shares and debentures) to the public is governed under the Securities Commission Act (SCA) 1993. However, the CLRC noted that the SCA 1993 does not actually state whether

[23] Section 18 of the Companies Act (Cap 50) now defines private company as a company having a share capital if its Memorandum and Articles of Association restricts the rights to transfer its shares and limits to not more than 60 the number of its members.

[24] Section 256(1) of the Singapore Securities and Futures Act (Cap 289) states that 'An offer of shares in or debentures of, or units of shares in or debentures of, a company for subscription or purchase, or an invitation to subscribe for or purchase shares in or debentures of, or units of shares in or debentures of, a company shall be deemed to be an offer to the public if—

(a) it is an offer or invitation by means of a rights issue which is renounceable in favour of persons other than existing members or debenture holders of that company; and

(b) an application has been or will be made for permission for the shares or debentures, or units of shares debentures, to be listed for quotation on any securities exchange.'

or not a private company may raise equity capital from the public. It only states that a private company is not required to comply with the SCA 1993 with regard to obtaining prior approval from the Securities Commission in relation to offerings of securities (except for an offer of debentures). The SCA 1993 also does not provide any definition of 'an offer to the public'. Instead, in place of 'an offer to the public', the SCA 1993 has adopted the concepts of 'excluded offers', 'excluded invitations' and 'excluded issues' and has identified which offering of securities need not comply with the prospectus requirements and other statutory provisions for investor protection in an offering of securities.[25] A proposal for an offer or invitation in relation to securities of a private company (other than the issue of debentures) does not require prior approval from the Securities Commission as it is deemed as an excluded offer or excluded invitation.[26] However, the SCA 1993 cannot be construed as giving authority to private companies to raise capital from the public. Because of this, the CLRC is of the view that if the restriction from raising capital by way of an offer to the public is removed, this could be interpreted to mean that a private company may make an offer of shares to the public for which there may be no adequate protection to the public.

4.10 A closer examination of the Companies Act 1965 reveals that although section 15(1) contains a restriction on private companies raising capital through public offers, section 4(6) specifies certain circumstances in which *bona fide* offers or invitations with respect to shares or debentures are not deemed to be an offer to the public. The circumstances are as follows:

[25] Schedule 2 of the SCA 1993.
[26] Paragraph 2 of Schedule 1 and Paragraph 17 of Schedule 2 of the SCA 1993. Schedule 2 of the SCA 1993 offers 27 instances of excluded offers or invitations.

(a) an offer or invitation to enter into an underwriting agreement;

(b) made to a person whose ordinary business it is to buy or sell shares or debentures whether as principal or agent;

(c) made to an existing member or debenture holder of a corporation and relating to shares in or debentures of that corporation, not being an offer to which section 46[27] of the SCA 1993 applies; or

(d) made to an existing member of a company within the meaning of section 270[28] of the Companies Act 1965 and relating to shares in the corporation within the meaning of that section.

4.11 The CLRC also noted that there has not been a consistent interpretation of what constitutes an offer to the public. For example, where the invitation is made to a restricted class of persons (irrespective of numbers), at what point does the invitation cease to be private and become a 'public offer'?[29] Therefore, the CLRC is of the view that the reference of 'an offer to the public' as is currently found in section 4(6) of the Companies Act 1965 should be clarified and recommends the adoption of section 769 of the UK Companies Bill 2006.

27 In relation to an abridged prospectus for a renounceable rights issue.

28 In relation to the power of liquidator to accept shares, etc., as consideration for sale of property of company.

29 See *Corporate Affairs (SA) v Australian Central Credit Union* [1985] 10 ACLR 59 which provides some guidance on what constitutes a public offer. Where an offer is made by a stranger and there is no rational connection between the characteristics which set the group members apart and the nature of the offer made to them, the group will, at least ordinarily, constitute a section of the public for the purposes of the offer. If, however, there is some subsisting special relationship between offeror and members of the group and the purpose for which the offer was made, then the question on whether the group constitutes a section of the public will be determined by reference to a variety of factors of which the most important will ordinarily be the number of persons comprising the group. See also *Mahima Singh v Baldev Singh* [1975] 1 MLJ 173 where it was held that where an invitation is made on a non-personal basis there could be an offer to the public even if only a few persons are actually allotted the securities.

4.12 The CLRC also noted that to a certain extent, private companies already have the ability to tap into the capital market particularly through the issuance of debentures (especially the issuance of bonds) to sophisticated investors within the meaning of section 4(6)(b) of the Companies Act 1965. A proposal for an offer or invitation in relation to debentures whether by a private or public company already requires prior approval of the Securities Commission.[30] The issuance of such instruments is highly regulated with adequate investors' protection mechanisms in place. This is why there are views that the restriction imposed on private companies from issuing debentures to the public may no longer be necessary.[31] Therefore, whilst the CLRC maintains that the law should continue to prohibit private companies from offering their shares to the public, the same restriction should not apply for the issuance of debentures.

RECOMMMENDATIONS:

4.13 The CLRC recommends that a private company should be defined as one where:

(a) the number of its members cannot exceed 50;

(b) the Articles of Association restrict the right of its members to transfer their shares; and

(c) an offer or issue of its shares (but not debentures) cannot be made to the public.

4.14 The CLRC also recommends the adoption of the definition of 'an offer to the public' in relation to the restriction on public offers by private companies as stated in section 769 of the UK Companies Bill 2006.

[30] Paragraph 2 of Schedule 1 and Paragraph 17 of Schedule 2 of the SCA 1993.
[31] As debenture holders are not members, allowing a private company to issue debentures to the public will not affect the shareholding structure of the company.

Questions for Consultation:

Question 3:
Do you agree that a private company be defined as one where the number of members cannot exceed 50?

Question 4:
Do you agree that private companies should continue to be prohibited from issuing shares to the public?

Question 5:
Do you agree that a private company should be allowed to issue debentures to the public?

Question 6:
Do you agree that the definition of 'an offer to the public' in relation to the restriction on public offers by private companies as stated in section 769 of the Companies Bill 2006 be adopted?

5.0 AUDITS, FINANCIAL REPORTING AND DISCLOSURE

5.1 The Companies Act 1965 makes it obligatory for companies to keep and maintain the company's accounts in compliance with the approved accounting standards, to have the accounts audited and to file the accounts with the regulatory authorities. As the Corporate Law Reform Programme aims to create a conducive business environment that will also promote accountability, the CLRC is concerned whether the above statutory requirements are able to support this objective, in particular for small companies.

5.2 The CLRC deliberated on the following issues:

(a) whether the requirement to keep and maintain the company's accounts should be retained for all companies;

(b) whether the mandatory audit rule should still be retained for all companies; and

(c) if the answer to either (a) or (b) is no, whether different types of companies should be treated differently, and the criteria for such treatment.

5.3 On whether the requirement to keep and maintain the company's accounts should be retained for all companies, the CLRC noted that the Companies Act 1965 requires directors to keep proper accounting records which will sufficiently explain the transactions and financial position of the company.

5.4 However, there are views that small companies may find the value and usefulness of keeping accounting records and preparing financial statements in accordance with approved accounting standards to be insignificant compared to the cost of doing so. It has been suggested that the preparation of financial statements is intended primarily for shareholders' protection and to a lesser extent, creditors and that there is no such need in the case of small companies which are owner-managed and do

not rely on external financing. There are also views that the present accounting requirements may be too complex for smaller companies.

5.5 In this regard, the CLRC believes that the initiative of the Malaysian Accounting Standards Board (MASB) to introduce a different set of accounting standards for private entities will address the needs of smaller companies. Furthermore, the CLRC maintains that the keeping of accounting records and the preparation of financial statements in compliance with approved accounting standards are important and recommends the retention of the present statutory requirements.

5.6 Where the audit requirement is concerned, the CLRC considered whether:

(a) audit should be mandatory for all types of companies; or

(b) there should be an exemption from the audit requirement for certain categories of companies.

5.7 In reviewing the mandatory audit rules, the CLRC commissioned a survey[32] to ascertain the value of a statutory audit from the perspective of directors of small-medium sized companies ('SMEs').[33] The directors were mostly of the view that statutory audits are beneficial, necessary and worthwhile for enhancing transparency, corporate governance and internal control, surpassing the benefit of using such audits for the purposes of taxes and bank financing. Most perceived that the benefits of audit outweigh the costs. Contrary to popular belief, the survey also indicated that the concerns over the costs of audit have not been as alarming as were initially anticipated. The results also showed that most of the directors who responded to the survey would be willing to carry out audits voluntarily, if the audits requirement were not mandatory under the Companies Act.

[32] Survey on 'Company Directors' View on Statutory Audit', 23 February 2006.
[33] The report on 'Company Directors' Views on Statutory Audit' is found in Appendix 1.

OPTION 1 – RETAINING THE MANDATORY AUDIT REQUIREMENT

5.8 It has been long accepted in company law that the reliability of financial statements will be increased if verification from an independent third party is obtained. Audit, being one of the cornerstones of corporate governance, provides reasonable assurance that financial statements of companies are free of material misstatements. It promotes accountability and transparency. Arguably, the mandatory audit of a company is a reasonable trade off for being able to operate with limited liability. Audit and financial reporting and disclosure obligations are also important to shareholders of the company and persons who rely on the information in their dealings with the company i.e. mainly creditors.

5.9 In comparable jurisdictions, audit exemptions have been allowed for certain small companies. One reason for such exemption may be the prohibitive costs of carrying out audits which may be perceived as outweighing the benefits of audit. For example, the UK experience reveals that the implementation of the Companies Act 1989 of the Eight Council Directive 84/253/EEC on auditors' qualifications has resulted in a disproportionate impact on the audit costs of very small firms. There was pressure to remove this requirement which was successful despite opposition from some users of accounts, notably the Inland Revenue and some banks.[34]

5.10 In Malaysia, the fees for a basic audit of accounts range from a minimum of RM300 to a few hundred thousand ringgit, depending on the complexity and depth of the audit. Some have argued that because of such costs, audit should not be mandatory for small, owner-managed companies, whose accountability does not extend beyond the owners.

[34] Gower and Davies' Principles of Modern Company Law, 7th Edn at p 564.

5.11 In Hong Kong, a recent proposal for audit exemption[35] was rejected by the Hong Kong Government based on the following reasons:

(a) that there are many users of financial statements other than the shareholders;

(b) that removal of the mandatory audit, coupled with the absence of minimum capital requirements, would leave creditors with practically no protection;

(c) that the costs of audit cannot be considered in isolation. Naturally, there will be savings on audit fees if the audit requirement is removed but the savings will not be significant. If financial statements must comply with generally accepted accounting principles, then professional accountants will be needed to assist in their preparation; and

(d) that the audit requirement, as opposed to a voluntary system, lends additional credibility to Hong Kong as a jurisdiction in which to form a company.

5.12 Other arguments on why there should not be audit exemption include the following:

(a) whilst it is noted that there is a need to reduce the regulatory and compliance burden particularly for smaller companies, there is also a concern that the removal of the audit requirement could result in accounts being prepared in a manner that is unduly favourable to the managers of such companies;

(b) audit exemption may lead to the possibility that accounts would not be prepared according to approved accounting standards;

(c) jurisdictions that have allowed audit exemptions are in an advanced stage of their economic development. The mature stage of their accounting and financial reporting frameworks, the long history of their accounting standard-setting and the long standing disclosure-based nature of their regulatory systems are contributory factors to the stance taken in allowing audit exemptions for

[35] The Report of the Standing Committee on Company Law Reform on the Recommendations of a Consultancy Report of the Review of the Hong Kong Companies Ordinance, February 2000.

certain types of companies. However, the Malaysian economy is still developing and removing the statutory audit requirement may have adverse effects on businesses and corporate governance standards;

(d) auditing standards require auditors to report to clients' management any significant defects in the financial and accounting systems and controls which have come to their attention during the course of the audit. Thus, the lack of financial expertise or managerial skills amongst SMEs could be mitigated through the advice given by the auditors as a result of an audit;

(e) audit provides assurance and adds credibility to the information provided to the stakeholders. In addition, audit ensures the integrity and reliability of publicly available information in the SSM's registry and lends additional credibility to Malaysia as a jurisdiction in which to form a company. If the statutory requirement for audit is removed, the monitoring process over these companies could be affected.

OPTION 2 – AUDIT EXEMPTION FOR CERTAIN TYPES OF COMPANIES

5.13 The main concern in relation to exemption from audit is in balancing between the needs of the company and that of public interest or public accountability. In jurisdictions that provide for differential treatment in relation to audit, the question whether audit should be mandatory is considered from the perspective of the necessity and value of audited accounts of a particular company to its shareholders and the public.

5.14 The CLRC noted the view that if there is no differentiation between the shareholders and managers of the company, the value of an audit is less significant. The degree of intimacy between the shareholders and managers removes the necessity to audit the trustee relationship between the two. Owners-managers may decide whether there is a necessity to conduct an audit for their own purposes or to satisfy the needs and interests of third party users.

5.15 Notwithstanding the above, the CLRC noted that the necessity and value of audited accounts to the public should be closely examined in so far as public accountability is concerned. The CLRC, however, noted that the qualitative criteria in determining public accountability are difficult to ascertain.

5.16 The International Accounting Standards Board (IASB), in its discussion paper[36] has attempted to ascertain whether or not an entity has public accountability by considering whether:

(a) there is a high degree of outside interest in the entity from non-management investors or other stakeholders, and if those stakeholders depend primarily on external financial reporting as their means of obtaining financial information about the entity; or

(b) the entity has an essential public service responsibility because of the nature of its operations.

5.17 The IASB has also proposed that an entity would be presumed to have public accountability based on the following indicators:

[36] Discussion paper on 'Preliminary Views on Accounting Standards and Medium-Sized Companies', June 2004 at paragraphs 28-32.

(a) it has filed, or is in the process of filing, its financial statements with the Securities Commission or any other regulatory organisation for the purpose of issuing any class of instruments in a public market;

(b) it holds assets in a fiduciary capacity for a broad group of outsiders, such as banks, insurance companies, securities brokers/dealers, pension funds, mutual funds or investment banks;

(c) it is a public utility or similar entity that provides an essential public service; or

(d) it is economically significant on the basis of criteria such as total assets, total income, number of employees, degree of market dominance, and nature and extent of external borrowings.

5.18 There are three approaches that may be adopted in relation to providing differential treatment for audit and financial reporting and disclosure obligations:

(i) to use the number of shareholders or membership structure as the sole criterion for the imposition or exemption from these obligations; or

(ii) to rely on the criteria of economic size or small/large distinction i.e. a threshold based on the company's assets, revenue and employees for imposition or exemption from these obligations; or

(iii) to apply a combination of the criteria of ownership structure and economic size for the imposition or exemption from these obligations.

5.19 The view that the number of shareholders or membership structure should be the sole criterion for the imposition or exemption from audit and financial reporting and disclosure obligations is presently reflected in the provisions of the Companies Act 1965 in relation to exempt private companies. The CLRC noted that the Australian Parliamentary Joint Statutory Committee on Corporations and Securities (PJSC)[37] has stated that:

[37] Report on Aspects of Regulation of Proprietary Companies, March 2001.

'Whilst the classification of companies as exempt and non-exempt reflected the status of the company, there was no consistent rationale for identifying companies in which there was a public interest. For example, very large companies, in which there may be a substantial public interest because they employed a large number of people, could be classified as exempt while minor enterprises could be non-exempt.'

5.20 In the UK, the Jenkins Committee Report[38] recommended that the exempt private company concept and all the special privileges it enjoyed be abolished. The recommendation was adopted by the UK Companies Act 1967, which required all companies to comply with the financial reporting obligations. Subsequently, the law was amended so that smaller private companies were only required to lodge a set of modified accounts with the Registrar. The UK approach was prompted by the European Economic Community (EEC) Twelfth Directive that requires smaller firms to have a less stringent financial reporting framework. Subsequently, the economic size or small/large tests based on the company's turnover, balance sheet and number of employees was drawn up based on the Fourth Directive of the EEC to ascertain whether there can be any exemption from the financial reporting obligations. Currently, the small/large distinction based on turnover and balance sheet thresholds as well as the number of employees is applied for the purpose of exemptions from the accounting and auditing obligations. The thresholds for the purpose of these exemptions have been revised several times over the years.[39] The UK Company Law Review in its 'Modern Company Law: Developing the Framework'[40] reviewed these criteria and found that they were still suitable to address the financial reporting obligations of small and closely held companies.

[38] Report of the Jenkins Committee on Company Law (June 1962 Cmnd. 1749) paragraphs 55 to 62.
[39] The current thresholds for small companies have been increased to £5.6m and £2.8m for turnover and balance sheet totals respectively; for medium companies the thresholds are £22.8m and £11.4m for turnover and balance sheet totals respectively.
[40] The UK Company Law Review, 'Modern Company Law: Developing the Framework', March 2000, Chapter 8.

5.21 In Australia, the First Corporate Law Simplification Act 1995 replaced the concept of exempt and non-exempt proprietary companies with the concept of distinguishing between small and large proprietary companies. However, to take advantage of the economic size distinction, a company must be a proprietary company which is defined based on the number of its shareholders (not more than 50). A company is then defined as a small or large proprietary company based on the company's assets, revenue and total number of employees. The underlying policy was to reduce the reporting obligations of small proprietary companies whilst ensuring that the reporting standards for large proprietary companies which have significant economic impact were strengthened. Large proprietary companies are required to prepare accounts, have them audited and to lodge them with the Australian Securities and Investments Commission (ASIC).

5.22 However, more recently, the Australian PJSC[41] concluded in its report that the previous distinction between exempt and non-exempt proprietary companies should be re-instated to reflect the two broad groups of proprietary companies: family owned type of companies and subsidiaries of disclosing entities. The reporting requirements should reflect these separate groups and the nature and size of ownership in proprietary companies. Nevertheless, the exempt proprietary test should recognise that there is a demand for financial information by creditors and others. On audit, the PJSC concluded that the ownership of the company is a better indicator of the need to impose an audit requirement as compared to the arbitrary test of a company's economic significance.

[41] The Australian Parliamentary Joint Statutory Committee and Securities, 'Report on aspects of the regulations of proprietary companies', March 2001.

5.23 The views of the PJSC as above were shared by Singapore's CLRFC which proposed that the exempt private company concept be retained. The CLRFC reasoned that as more than 80 per cent of the exempt private companies have shareholders who are also directors, it was reasonable that such owner managed companies be exempted from certain regulatory requirements. The CLRFC preferred to retain the current criteria in determining what constitutes an exempt private company as these are easy to understand and would not require regular revisions. Further, the Singapore business community is familiar with the current definition. However, the CLRFC extended the application of the exempt private company concept by proposing that exempt private companies having an annual turnover of S$5 million and below be exempted from the statutory audit and filing of their audited accounts. The Minister has the power to increase the threshold from time to time. The CLRFC was of the opinion that this will exclude the bigger exempt private companies, while allowing the smaller companies to benefit.

5.24 It was proposed by the CLRFC that the deregulatory measures for the removal of statutory audit be complemented with a safeguard of allowing shareholders holding at least 5 per cent of the total voting shares to require the company to have its accounts audited. In addition, the Registrar has also been given the power to direct companies to have their accounts audited.

5.25 On the view that economic size should be the determining criteria for differential treatment, this has been summed up by the UK Company Law Review as follows:

> *'Which measure – economic size, the number of shareholders, or a combination of the two – offers the most appropriate criterion in relation to wider public interest? Number of shareholders might be an appropriate criterion if company accounts were relevant only to shareholders' interests; but they have much wider value. In any case, while there are legitimate reasons for regarding the needs of companies for reporting as less where there are few shareholders (and probably a significant overlap between shareholders and managers); in most cases this could be achieved by adopting an economic size criterion. Economic size on the other hand is an obvious proxy for the economic impact of the company on members, employees and those with whom it interacts.'*

5.26 In the Malaysian context, the CLRC is of the opinion that the present differential treatment based on the exempt private company criteria alone may not be sufficient to cater to the needs of small companies because:-

(a) only the ownership structure is emphasised as the only criteria for the exemption from the financial reporting obligation. This does not reflect the fact that there are exempt private companies that are large in terms of economic size; and

(b) whilst the basic intention of the exempt private company definition was to exempt small private companies which were not subsidiaries of public companies from the obligation of filing accounts, it would include some companies which cannot be described as small, for there are companies through which a comparatively small number of individuals, all beneficially interested, nevertheless control large businesses.[42]

[42] This was raised even by the Cohen Committee when formulating the definition. The Cohen Committee nevertheless was against defining the concept through economic size.

5.27 The CLRC noted that the economic size criteria received criticism mainly due to the arbitrariness of the tests used in determining the small/large distinction. There are views that the tests used for small/large distinction for private companies could result in incorrect classification and therefore inadequate protection for creditors. There would also be the need to revisit the threshold from time to time to reflect the current business environment.

5.28 As such, the CLRC considers that any proposed differential treatment should be based on a combination of both ownership structure and economic size. These would be suitable criteria to determine whether or not there is public accountability in companies for the purposes of any imposition or exemption of audit, financial reporting and disclosure obligations. The CLRC further considers the private/public distinction that is based on ownership structure and the restriction on capital raising from the public reflects the indicators of public accountability proposed by the IASB, specifically the presumption that once an entity embarks on issuing any of its shares to the public, it is a publicly accountable entity and should not be exempted for auditing, accounting or financial reporting obligations.

5.29 The CLRC is further of the view that there are certain types of companies which should not be exempted from financial reporting obligations irrespective of ownership structure or economic size. These are companies that hold assets in a fiduciary capacity for or have obligations or liabilities to a broad group of outsiders such as banks, insurance companies, securities brokers/dealers, pension funds, mutual funds or investment banks.

5.30 If the view is taken that there should be differential treatment in relation to the audit requirement, the CLRC is of the view that the following criteria should be used to determine the types of companies that may enjoy the exemption:

(a) that the company is a private company (in the shares of which no beneficial interest is held directly or indirectly by any corporation and having not more than 50 shareholders none of whom is a corporation); and

(b) that the company meets at least two of the economic size indicators with prescribed thresholds including annual turnover, balance sheet total and number of employees.[43]

5.31 Having presented the arguments for and against in respect to its review on the mandatory audit rules, the CLRC seeks consultation on the better alternative between the proposed two options which are:

(i) That audit should be mandatory for all types of companies; and

(ii) That there should be an exemption from the audit requirement for certain categories of companies.

Questions for Consultation:

Question 7:

Do you agree that the present mandatory audit rules should be retained?

[43] The prescribed thresholds may be formulated based on MASB Statement of Principles 1 (SOP) that provides a definition of Exempt Enterprises for financial reporting purposes. An exempt enterprise must fulfil the following conditions:
(a) The enterprise does not have public accountability;
(b) At balance sheet date, all of its owners are members of the enterprise's governing body;
(c) The enterprise fulfils at least two of the following criteria:
(i) an annual gross revenue of not more than RM10 million;
(ii) gross assets of not more than RM5 million at the end of financial year; or
(iii) having an average of not more than 50 employees for the financial year.

Question 8:

If your answer to question 1 is no, do you agree that certain types of companies should be exempted from audit requirements?

Question 9:

If your answer to question 2 is yes, do you agree that the exemption from audit requirements should be based on the following criteria?

- **(a) that the company is a private company (in the shares of which no beneficial interest is held directly or indirectly by any corporation and which has not more than 50 members none of whom is a corporation); and**
- **(b) that the company meets at least two of the following economic size indicators with certain prescribed thresholds:**
  - **(i) an annual gross revenue;**
  - **(ii) an annual of gross assets; and**
  - **(iii) total number of employees.**

What do you think would be the appropriate thresholds for the economic size indicators?

Question 10:

Do you agree that companies that hold assets in a fiduciary capacity for, or have obligations or liabilities to, a broad group of outsiders such as banks, insurance companies, securities brokers/dealers, pension funds, mutual funds or investment banks should not be exempted from financial reporting obligations irrespective of ownership structure or economic size?

CONSEQUENTIAL LAW REFORM SHOULD THE MANDATORY AUDIT REQUIREMENT BE ABOLISHED FOR PRIVATE COMPANIES

5.32 The Companies Act 1965 requires all companies to lay the audited financial statements before their annual general meetings. This requirement is to ensure that members have the opportunity to question the directors on the companies' performance and affairs during the year as indicated by the financial statements.

5.33 The directors are required to circulate the audited financial statements at least 14 days before the annual general meeting to those entitled to receive notice of the meeting or within a shorter period from the date of the meeting if agreed to by all shareholders.[44] In addition, upon request of any member or debenture holder to whom a copy has not been sent, a company must send a copy of the financial statement without imposing any charge on them.[45]

5.34 Under the present financial reporting and disclosure framework, exemption is given to exempt private companies[46] but only in respect of the requirement to lodge/file their audited accounts with the annual returns to the Registrar. Instead, the annual returns of the exempt private company must include a certificate signed by a director of the company, the secretary and an auditor to the effect that the company has been an exempt company at all relevant times; that duly audited financial statements have been laid before the company in a general meeting; and that the company appears to be able to meet its liabilities as and when they are due.[47]

[44] Section 170(1) of the Companies Act 1965.
[45] Section 170(3) of the Companies Act 1965.
[46] Section 4(1) of the Companies Act 1965 defines an exempt private company as a private company in the shares of which no beneficial interest is held directly or indirectly by any corporation and which has not more than twenty members none of whom is a corporation.
[47] Eighth Schedule of the Companies Act 1965.

5.35 In its Third Consultative Document entitled 'Engagement with Shareholders',[48] the CLRC recommended that private companies should no longer be required to hold annual general meetings. Although as a safeguard, any member may demand that a general meeting be held for the purposes of having the financial accounts laid. However, the requirement to circulate financial accounts to all members is being retained. Section 170 of the Companies Act 1965, therefore, needs to be redrafted if annual general meetings are no longer mandatory for private companies.

5.36 As noted earlier, there is a concern that the monitoring process of these companies could be affected should audits no longer be mandatory. This concern has been shared by other comparable jurisdictions.

5.37 In Singapore, the CLRFC retained the statutory obligation to maintain the accounting records although it is now an option for certain companies to have their accounts audited. As safeguard measures, the CLRFC recommended that where companies are exempted from audits, directors are required to issue an annual statement stating that the company has:

(i) kept accounting records that correctly record and explain the transactions and the financial results and position of the company;
(ii) kept accounting records in such manner as would enable true and fair financial statements of the company to be prepared; and
(iii) kept its accounting records in such a manner as would enable the accounts of the company to be conveniently and properly audited.

[48] Corporate Law Reform Committee, 'Engagement with Shareholders', February 2006.

5.38 The CLRFC has recommended that exempt private companies having an annual turnover below S$5 million be required only to lodge annual returns with declarations of solvency signed by one director who is authorised to do so. Failure to do so will necessitate a company to file its unaudited accounts. The CLRFC reasoned that based on the existing exempt private company regime, where companies were not required to lodge their audited accounts, and the fact that the public did not have access to the financial information of such companies, there would not be any erosion of the quality of public disclosure and information obtainable from the Registrar. However, although exempt private companies having an annual turnover above S$5 million are not required to lodge their audited accounts, they are required to include in their annual return key financial indicators.[49]

5.39 In the UK, whilst the Companies Bill 2006 maintains the requirement to keep proper accounting records, companies which are subject to the 'small companies' regime'[50] are exempted from the audit requirements and a statement to this effect must be made in the company's balance sheet.[51]

5.40 The UK Company Law Review had recommended that instead of filing abbreviated accounts (which would enable companies to keep some information confidential), all small and medium companies be required to submit their full statutory accounts, for greater transparency. However, the UK Government decided to retain the

[49] The Eighth Schedule of the Companies Act (Cap 50) requires exempt private companies without exempt private company certificates to include in their annual report key financial indicators including turnover, sales and other operating revenue; nett income (or less) from extraordinary and non-operating items; profit or loss; assets and liabilities; and shareholders' funds.

[50] See Part 16 Chapter 1 of the Companies Bill 2006. For a company to qualify for a differential treatment under the small companies regime, it has to be small and not excluded from the regime. A small company must meet at least two of the following criteria:
(i) annual turnover of not more than £5.6 million;
(ii) balance sheet total of not more than £2.8 million;
(iii) number of employees of not more than 50.
Companies excluded from the small companies' regime are public companies, banks and insurance companies, or a member of an ineligible group. A group is ineligible if any of its members is a public company, quoted body corporate or a bank or an insurance company.

[51] As a safeguard, shareholders holding more than 10 per cent of the shares may require the company to have its accounts audited.

practice of submitting abbreviated accounts, but required both small and medium sized companies to disclose the amount of turnover for the relevant financial year.[52]

5.41 In Australia, the thrust of its review on financial reporting and disclosure was to require all companies to keep accounting records so that financial statements could be prepared, but to remove the statutory obligation for small proprietary companies to prepare and file financial statements unless asked to do so by the members or ASIC.[53] A small proprietary company preparing its financial statements in response to members' direction must send the report to its members but need not lodge it with the ASIC.

5.42 Furthermore, a company which has not lodged a financial report to the ASIC within 12 months before the review date,[54] must pass a solvency resolution within 2 months after the review date. If the directors pass a negative solvency resolution, the company must notify ASIC within 7 days after the resolution is passed.

Questions for Consultation:

Question 11:
Do you agree that companies eligible for exemptions should still be required to file key financial indicators (assets, turnover) to SSM together with their annual return?

52 The UK Department of Trade and Industry: White Paper on Company Law Reform, March 2005 at p 46.
53 As was first encapsulated in one of the first initiatives of the corporate law programme through the Company Law Review Act 1998.
54 CLERP 7 has abolished the annual returns for companies, requiring instead a return of particulars and the payment of an annual review fee based on a review date specific to an individual company. The review date is the anniversary date of a company's incorporation unless otherwise specified and agreed by ASIC.

6.0 COMPANY SECRETARIES

6.1 Section 139 of the Companies Act 1965 requires every company to have at least one company secretary who shall be present at the registered office of the company by himself or his agent on the days and at the hours during which the registered office is accessible to the public.[55] The Companies Act 1965 does not make any distinction between public and private companies in relation to the requirements for company secretaries.

6.2 At present, all companies are required to appoint at least one company secretary who is a natural person of full age and has a principal or only place of residence in Malaysia.[56] In 1992, the Companies Act 1965 was amended to include the requirements that before a person can be appointed as a company secretary, he must be a member of a prescribed body[57] or licensed by the Registrar for that purpose.[58] This was to ensure that appointed company secretaries possessed a certain degree of competency and professionalism in carrying out their duties and responsibilities.

6.3 The appointment of a company secretary is the responsibility of the directors of a company.[59] Generally, the Articles of Association of the company will provide for the manner of appointment, removal or resignation of a company secretary.[60]

[55] The legal requirement for every company to have at least a company secretary is due to the fact that a registered company being an artificial person as distinct from its members requires a human agent to whom all enquiries and correspondence with the company can be addressed and who can interact with the public regarding affairs of the company.
[56] Section 139 of the Companies Act 1965.
[57] Section 139A(a) of the Companies Act 1965. The prescribed bodies for the purpose of this section are:
(i) Malaysia Institute of Accountants (w.e.f. from 10 September 1992);
(ii) Malaysian Institute of Certified Accountants (w.e.f. 10 September 1992);
(iii) The Malaysian Institute of Chartered Secretaries and Administrators (w.e.f. 10 September 1992);
(iv) Bar Council (w.e.f 23 December 1993);
(v) Sabah Law Association (w.e.f 28 February 1994);
(vi) The Advocates' Association of Sarawak (w.e.f 30 April 1994);
(vii) Malaysian Association of Company Secretaries (w.e.f 1 September 1997).
[58] Section 139A(b) of the Companies Act 1965. Further Section 139B states that the application for licence shall be made to the Registrar in a prescribed form and manner.
[59] Section 139(3) of the Companies Act 1965.
[60] Article 95, Table A of the Companies Act 1965.

6.4 The provision that every company must have a secretary does not require the company to engage the secretary on a full-time basis (i.e. as an 'in-house' secretary). Companies may engage the services of an external secretary or a company secretarial service provider. The Companies Act 1965 also does not distinguish between the appointment of 'in-house' or 'external' company secretary.

6.5 The roles and functions of company secretaries are not expressly defined or stated in the Companies Act 1965 although it is generally agreed that company secretaries play an important role in ensuring that a company complies with the relevant laws and regulations governing companies.

6.6 It is not easy to describe the role of a company secretary. He is usually the link between the directors and the staff, the shareholders, the press, the public and sometimes the consumers and suppliers. His duties, to a large extent, are not fixed by law but are assigned to him by the Articles of Association of the company or his contract of appointment.

6.7 Generally, the functions of a company secretary are purely administrative in nature. The fundamental duties of the company secretary are the statutory duties, in particular, ensuring compliance by the company with the disclosure and information requirements of the Companies Act 1965 and adherence by the board to the procedures.

6.8 The duties and responsibilities of a company secretary can be very wide depending on the size of the company and the nature of the company's business operations. Company secretaries commonly perform the following functions:

- organising and attending meetings of directors and shareholders, including sending out notices, preparing agendas and keeping minutes;
- preparing resolutions for the directors and shareholders as instructed by the directors of the company;
- keeping and maintaining the various registers required to be kept under the Companies Act 1965;
- preparing and submitting all returns and prescribed forms required to be lodged with the Registrar within the appropriate time limits;
- acting as custodian of the common seal, statutory books and returns, and keeping important documents of the company;
- keeping and maintaining the registered office of the company;
- authenticating documents and proceeding for the company;
- if the company is listed, advising the board of the company the post listing obligations as imposed by the listing requirements of the Stock Exchange, and preparing and releasing announcements to the Stock Exchange;
- advising the chairman and the directors of meeting procedures both under the Companies Act 1965 and under the company's Memorandum and Articles of Association; and
- dealing with matters relating to the company's share capital, including preparing documents for share issues and handling share transfers.

6.9 At common law, company secretaries are increasingly given wider recognition in the day-to-day management of the company.[61] Company secretaries are also increasingly given recognition in their role in providing independent advice to the board.

[61] A secretary's ostensible authority includes signing contracts connected with the administrative matters of the company; see *Panorama Developments (Guildford) Ltd v Fidelis Furnishing Fabrics Ltd* [1971] 2 QB 711. However, a company secretary is not part of management and has no power to make commercial decisions on behalf of the company; see *Mohamed bin Othman v Abdul Shattar bin Abdul Rahim* [1987] 2 MLJ 695.

6.10 Under the Companies Act 1965, a company secretary is recognised as an officer of the company[62] and therefore where an offence is stated to be committed by an 'officer in default' this will include the company secretary.

6.11 There is also the developing role of company secretaries in advising the board on their compliance obligations under the law. This is not purely administrative, but an advisory role. The CLRC noted that company secretaries in Malaysia play an important role in ensuring that good corporate governance standards are complied with by companies and their directors. This was given recognition by the High Level Finance Committee on Corporate Governance in its Report on Corporate Governance.[63]

6.12 The CLRC noted that the discussion on company secretaries in other jurisdictions focussed on the following:

(a) the need for company secretaries for all types of companies; and

(b) the competency and professionalism of company secretaries.

6.13 In the UK, the Company Law Review recommended the abolition of company secretaries for private companies on the basis that the decision to appoint a secretary should be decided by market demands rather than by law. The proposal would give flexibility to companies in their internal administrative arrangements.[64] This proposal has been endorsed by the UK Government[65] for the reason that a company secretary's role, though valuable, is not essential to good corporate governance;

[62] Section 4(1) of the Companies Act 1965.

[63] February 1999, at Chapter 5, paragraphs 4.55 and 4.56, page 90 states that company secretaries have a key role in ensuring that board procedures are followed regularly and reviewed. Their close proximity to the Board makes them ideal candidates to undertake the advisorial roles in respect of compliance issues. The Chairman will look to the company secretary for guidance on what their responsibilities are under the rules and regulations and how those responsibilities should be discharged. The compliance advice should extend to embrace all laws and regulations, not merely the routine filing requirements and other administrative requirements of the Companies Act.

[64] The UK Company Law Review on Modern Company Law: Final Report at para 4.7, June 2001.

[65] Modern Company Law: White Paper, July 2001.

that is properly the responsibility of directors. Private companies may choose to appoint company secretaries on the basis of the value that they add to the company. This is similar to the provisions of the Singapore Companies Act. In New Zealand, the Law Commission on Company Law Reform and Restatement Report No. 9 recommended that there should not be any mandatory requirement for the appointment of company secretaries. The Law Commission reasoned that directors are responsible for the company's management and that to provide for management functions below the level of directors would be to undermine their responsibility and accountability.[66] The Law Commission's recommendation was adopted by the New Zealand Companies Act 1993.

6.14 The CLRC noted that whilst there is a need for company secretaries, the issue is whether such need should be imposed by law. In practice, companies have the option to use an in-house company secretary or an external company secretary. Often, larger companies will employ a company secretary, whilst smaller companies may find it more economical to engage company secretarial firms. In some private companies, the directors themselves sometimes undertake the functions normally performed by the company secretary.

6.15 The CLRC acknowledges that compliance costs in relation to the mandatory appointment of company secretaries are minimal and that the reduction of compliance costs for private companies should not be the sole reason to dispense with the requirement to appoint company secretaries for private companies. Without a company secretary, the company's statutory obligations would still have to be performed by another person. The costs of compliance would potentially increase if the functions of the company secretaries are performed by persons who are

[66] New Zealand Law Commission on Company Law Reform and Restatement Report No 9, June 1989 at paras 287 – 290.

incompetent. In addition, the public confidence in the accuracy of public registers should be taken into consideration.

6.16 Where competency and professionalism of company secretaries are concerned, the CLRC noted that in Singapore, with effect from 15 May 2003, a private company is no longer required to appoint a professionally qualified company secretary. However, directors are required to take all reasonable steps to ensure that each company secretary appointed by them has the requisite knowledge and experience.[67] If the Registrar is not satisfied with the compliance of the company in relation to provisions of the Companies Act, the Registrar has the power to direct the company to appoint a professionally qualified secretary.[68] Similarly, in Hong Kong, only public listed companies are required to appoint a professionally qualified secretary. For other non-listed companies, company secretaries need not be professionally qualified.

6.17 It is to be noted that in Malaysia, prior to 1992, company secretaries were not required to be professionally qualified. In 1992, the Companies Act 1965 was amended introducing a new section 139A where a person must be professionally qualified or licensed by the Registrar before he can act as a company secretary. The rationale was to ensure professionalism and competency amongst company secretaries. This resulted in the unique present composition of the profession where both professionally qualified and licensed individuals are recognised to act as company secretaries.

[67] Section 171(1A) of the Companies Act (Cap 50).
[68] Section 171(1AB) of the Companies Act (Cap 50).

6.18 Since the introduction of section 139A, compliance amongst companies has improved. There has also been marked improvement in the quality and accuracy of documents filed and lodged with the Registrar. The CLRC noted concerns that the appointment of non-professionally qualified company secretaries may have an impact on the cost of compliance and enforcement as well as on corporate governance standards. The CLRC is of the view that the main concern is to ensure that there should be a mechanism to ensure that company secretaries are competent. One of the ways of ensuring competency is through professional qualification and/or proper accreditation and monitoring by professional bodies or associations.

6.19 The CLRC believes that professional qualification for company secretaries will enhance the standard of professionalism and competency within the profession. But the responsibility to monitor company secretaries should not be left entirely to the professional bodies, as not all members of the prescribed bodies practise as company secretaries. In this respect, the CLRC proposes that a monitoring mechanism in the form of a register of company secretaries be established by SSM.

RECOMMENDATIONS:

6.20 The CLRC recommends that:

(i) the mandatory appointment of company secretaries for all types of companies be retained; and

(ii) there should be a register of company secretaries to be managed and controlled by SSM.

Questions for Consultation:

Question 12:

Do you agree that a specific person should be appointed to carry out the functions of a company secretary?

Question 13:

If yes, do you agree that such a person must be professionally qualified?

Question 14:

If no, do you think the directors (or his agents) are able to carry out the functions to an acceptable level of competency?

Question 15:

Do you agree that a register of company secretaries be established by SSM to monitor company secretaries?

7.0 THE CAPACITY OF A COMPANY TO CONTRACT AND CONSTRUCTIVE NOTICE

COMPANY'S CAPACITY

7.1 Upon incorporation, a company is required to state its objects in its Memorandum of Association. The objects clause of a company defines the company's capacity and sets the parameters in which a company carries on it commercial activities. At common law, acts or transactions entered into by the company which are outside the objects clause are *ultra vires* [69] and cannot be ratified by the company.

[69] *Ashbury Railway Company Ltd v Riche* [1875] LR 7 HL 653.

7.2 The objects clause and the corollary *ultra vires* doctrine were initially regarded as and intended for providing protection to shareholders and creditors in the following manner:

(i) by limiting the operations of the company. The limit will ensure that the business risk that is taken into account by shareholders in contributing equity and creditors in providing credit to the company does not change without shareholders' and creditors' knowledge and consent. The limit will also ensure that there is no dissipation of a company's assets through unauthorised transactions and activities.

(ii) by enabling shareholders in joint venture companies and special purpose vehicles to determine the scope of activities that may be undertaken by the company.

7.3 An objects clause is also important for companies established under section 24 of the Companies Act 1965 for charitable purposes in ensuring that such companies do not carry out activities which are contrary to their charitable objects.

7.4 However, there are arguments that the objects clause and the *ultra vires* doctrine are no longer relevant. For example, the Cohen Committee disagreed with the view that the objects clause and the *ultra vires* doctrine can protect shareholders' and creditors' interests. The Cohen Committee was of the view that the *ultra vires* doctrine provides 'an illusory protection for the shareholders and yet may be the pitfall for third parties dealing with the company'.[70] This is because shareholders are more concerned about the commercial profitability of a particular transaction than its constitutionality. Creditors, on the other hand, are more concerned about the ability

[70] Report of the Committee on Company Law Amendment (1945).

of the company to pay debts as they fall due. The objects clause may also not facilitate business as it creates an undue burden on third parties who have to verify whether or not the company has the capacity to enter into the transaction. Additionally, the *ultra vires* doctrine is considered too rigid as it restricts the range of commercial transactions or pursuits that companies may otherwise legitimately undertake. Whilst a company is allowed to amend its object clause, this may be costly and time consuming and may result in the company not being able to seize business opportunities expeditiously.

7.5 Also, the *ultra vires* doctrine has been circumvented through ingenious drafting. In practice, companies list out a wide range of activities irrespective of whether they will eventually be carried out, for fear of engaging in activities which are beyond the companies' capacity. This often results in a lengthy objects clause or an objects clause which states that the company's object is to carry on businesses as determined by the directors. It is also a common practice for companies to set out sub-clauses on the powers accorded to the companies in carrying out the objects. However, it is arguable that such practices may not be in conformity with the law since the legal position is that there is a difference between the objects and powers of a company.[71]

7.6 Furthermore, the *ultra vires* doctrine has confusingly been used to restrict directors' authority, or to refer to conduct in breach of a company's Articles of Association, or in breach of directors' powers.

[71] *Rolled Steel Products (Holdings) Ltd v British Steel Corporation* [1984] BCLC 466.

7.7 The CLRC noted that guidelines were issued by the Registrar, under the direction of the Cabinet, specifying that newly incorporated companies must now limit their objects to not more than three.[72] The guidelines also state that the powers accorded to a company need no longer be stated in the Memorandum and that it is sufficient to refer to such powers as are provided under the Third Schedule of the Companies Act 1965. However, such an arrangement could be interpreted as further restricting the range of commercial transactions that a company may undertake. The CLRC also noted that the practice of limiting object clauses to not more than three is done for the purposes of incorporation only. After incorporation, many companies alter their objects clause to include more objects, which defeats the purpose of the guidelines.

7.8 The CLRC also noted that section 20 of the Companies Act 1965 has, to a certain extent, modified the *ultra vires* doctrine in Malaysia and provided protection on third party dealings with the company. Section 20(2) provides that no act or purported act of a company shall be invalid by reason only of the fact that the company was without capacity or power to do such act. Section 20 further provides that any such lack of capacity or power can only be relied on in the following circumstances:

(a) proceedings against the company by any member of the company or, where the company has issued debentures secured by a floating charge over all or any of the company's property, by the holder of any of those debentures or the trustees for the holders of those debentures to restrain the doing of any act or acts or the conveyance or transfer of any property to or by the company;

[72] However, architectural and engineering companies are allowed to have more than 3 objects due to the nature of their operations.

(b) any proceedings by the company or by any member of the company against the present or former officers of the company; or

(c) any petition by the Minister to wind up the company.

The effect of section 20 is that the *ultra vires* doctrine is preserved only for the purposes stated above. The CLRC recommends its retention.

7.9 The CLRC is of the view that the *ultra vires* doctrine should be abolished and that a company should be given the powers of a natural person. This would mean that a company is not required to specify its objects. Company legislation should allow flexibility in organising a company's business. Nevertheless, a company should be able to limit its objects should it wish to do so. In this case, the objects would still be relevant to members and in proceedings by members against any directors or former directors as well as by the Minister in a petition to wind up the company. A company would still have capacity to contract even if it entered into transactions which were outside its objects. The CLRC also recommends that this proposal should be applicable only to newly formed companies. The CLRC further agrees that a transitional period be given for existing companies to amend their Memorandum and Articles of Association to allow them unlimited capacity.

7.10 However, the CLRC believes that for companies formed pursuant to section 24[73] of the Companies Act 1965 should continue to specify their objects.

[73] Section 24 of the Companies Act 1965 allows the omission of the word 'Berhad' from names of companies provided that they are formed for the purpose of providing recreation or amusement or promoting commerce, industry, art, science, religion, charity, pension or superannuation schemes or any other object useful to the community, and will apply their profits or other income in promoting its objects and will prohibit the payment of any dividend to their members.

DOCTRINE OF CONSTRUCTIVE NOTICE

7.11 The constructive notice doctrine establishes the general rule that persons dealing with a company are deemed to have notice of what is contained in its public documents, including the Memorandum and Articles of Association. The constructive notice doctrine usually applies in relation to the objects clause of the company. Since the objects clause is stated in the Memorandum, third parties are deemed to have notice of the objects clause and they will not be able to enforce transactions which contravene the objects clause.

7.12 Given that the CLRC recommends that the *ultra vires* doctrine shold be abolished, it follows that the constructive notice doctrine as it applies in relation to the objects clause would no longer be relevant.

7.13 The Companies Act 1965 also requires the lodgement of certain prescribed forms and documents with the Registrar, for example, Form 49. The CLRC recommends that the doctrine of constructive notice in relation to these documents should be abolished and that third parties should not be deemed to have constructive notice of the contents of documents that are lodged with the Registrar and that a third party is not required to inquire into whether or not the transaction is permitted by the company's constitution or beyond the powers of the directors. However, the CLRC believes that the application of the constructive notice doctrine should be retained in cases of company charges.

RECOMMENDATIONS:

7.14 The CLRC recommends that:

(a) newly formed companies should, unless the company otherwise elects, have the full capacity of a natural person and that a transitional period be given to existing companies to alter their Memorandum and Articles of Association to have unlimited capacity;

(b) companies formed pursuant to section 24 are still required to specify their objects;

(c) section 20 of the Companies Act 1965 be retained; and

(d) the doctrine of constructive notice be abolished except in its application to company charges.

CROSS JURISDICTIONAL STUDY

United Kingdom

7.15 The UK Company Law Review recommended that a company should have unlimited capacity, but where the company retains provisions in its constitution which would limit its capacity, it proposed that the rights of members to take proceedings to restrain the doing of anything against the provisions be retained, without prejudice to the rights of third parties.[74] This is reflected in subsections 32(1), (2) and (3) of the UK Companies Bill 2006:

'Statement of company's object—

(1) Unless a company's articles specifically restrict the objects of the company, its objects are unrestricted.

[74] Modern Company Law for a Competitive Economy: Company Formation and Capital Maintenance, October 1999 at para 2.35.

(2) Where a company alters its articles so as to add, remove or alter a statement of the company's objects—

(a) it must give notice to the registrar,

(b) on receipt of the notice, the registrar shall register it, and

(c) the alteration is not effective until entry of that notice on the register.

(3) Any such amendment does not affect any rights or obligations of the company or render defective any legal proceedings by or against it.'

7.16 It was also proposed that where directors act contrary to such provisions it should be possible for members to ratify those actions by an ordinary resolution. To complement the abolition of the *ultra vires* doctrine and statutory conferment of a legal person's powers to companies, the UK Company Law Review has also proposed that the deemed notice rules be abolished with the exception of notices in respect to register of charges.

Australia

7.17 The Australian Corporations Act 2001 also provides that 'a company's legal capacity to do something is not affected by the fact that the company's interests are not and would not be served by doing it'.[75] The Australian legislation further provides that if a company has a constitution, it may contain an express restriction on, or a prohibition of, the company's exercise of any of its powers and further that if a company has a constitution, it may set out the company's objects. It goes on to provide that an act or the exercise of a power is not invalid merely because it is contrary to an express restriction or prohibition, or beyond any objects. The legislation prescribes the manner in which a person dealing with a company or its agent should act. It also specifies that

[75] Section 124 (2) of the Corporations Act 2001.

a person dealing with a company is entitled to make certain assumptions[76] provided that at the time of the dealing they did not know or suspect that the assumption was incorrect. With regard to constructive notice, the legislation provides that (save in the case of a charge that is registrable under the Act) 'a person is not taken to have information about a company merely because the information is available to the public from ASIC'.[77]

New Zealand

7.18 The New Zealand Companies Act 1993 provides that (subject to the other provisions of the Act) 'a company has full capacity to carry on or undertake any business or activity, do any act, or enter into any transaction, and for [these purposes has] full rights, powers and privileges'.[78] It provides also that subject to certain exceptions 'no act of a company and no transfer of property to or by a company is invalid merely because the company did not have the capacity, the right, or the power to do the act or to transfer or take a transfer of the property'.[79] It further provides (as in Australia) that 'the fact that an act is not, or would not be, in the best interests of a company does not affect the capacity of the company to do the act'.[80] On the doctrine of constructive notice, the Companies Act 1993 provides that 'a person is not affected by, or deemed to have notice or knowledge of the contents of, the constitution of, or any other document relating to, a company merely because – (a) the constitution

[76] (1) A person may assume that the company's constitution (if any), and any provisions of this Law that apply to the company as replaceable rules, have been complied with.
(2) A person may assume that anyone who appears, from information provided by the company that is available to the public from ASIC28, to be a director or a company secretary of the company:
(a) has been duly appointed; and
(b) has authority to exercise the powers and perform the duties customarily exercised or performed by a director or company secretary of a similar company.
(3) A person may assume that anyone who is held out by the company to be an officer or agent of the company:
(a) has been duly appointed; and
(b) has authority to exercise the powers and perform the duties customarily exercised or performed by that kind of officer or agent of a similar company.'

[77] Section 130 of the Corporations Act 2001.

[78] Section 16 of the Companies Act 1993.

[79] Section 17(1) of the Companies Act 1993.

[80] Section 17(3) of the Companies Act 1993.

or document is registered on the New Zealand register; or (b) it is available for inspection at an office of the company'.[81]

Singapore

7.19 The Singapore CLRFC recommended that a company should be statutorily conferred with the powers of a natural person and recommended the total abolition of the *ultra vires* doctrine. However, the CLRFC has recommended retaining the *ultra vires* doctrine where the constitution of the company places limits on a company's capacity and powers, by preserving the rights of internal redress by members against the directors.[82] The Singapore Companies Act has also abolished the constructive notice rule.[83]

Questions for Consultation:

Question 16:

Do you agree that a company should be statutorily conferred with the full capacity of a natural person, regardless of anything in its constitution, including its objects?

Question 17:

Do you agree that the doctrine of *ultra vires* should be abolished except in so far as it applies to members of the company and in proceedings by members against any directors or former directors as well as any petition by the Minister to wind up the company?

81 Section 19 of the Companies Act 1993.
82 The Company Legislation and Regulatory Framework Committee Report, para 5.2. It recommended adopting the New Zealand Law Commission Company Law Reform and Restatement Report No 9 (1989) section 7 and 8. These are adopted with modification from sections 16 and 17 of the New Zealand Companies Act 1993.
83 Section 25A of the Companies Act (Cap 50).

Question 18:

Do you agree that it should be expressly provided that third parties are not deemed to have constructive notice of contents of documents lodged with the Registrar and that a third party is not required to inquire into whether or not the transaction is permitted by the company's constitution or beyond the powers of the directors?

Question 19:

Do you agree that constructive notice be abolished except in so far as the Register of Charges is concerned?

Question 20:

Do you agree that companies registered under section 24 of the Companies Act 1965 (i.e. not-for-profit companies) should continue to be required to have objects clause?

8.0 COMPANY FORMATION AND RELATED MATTERS

8.1 The CLRC identified and deliberated on the following issues:

(a) types of companies that can be incorporated;

(b) the minimum number of members and directors of companies;

(c) incorporation and registration of companies; and

(d) enabling the use of information and communication technology (ICT) in relation to the incorporation and filing process.

A TYPES OF COMPANIES THAT CAN BE INCORPORATED

8.2 In addition to the private/public distinction, section 14 of the Companies Act 1965 classifies companies based on the nature of liability imposed on members upon winding-up as follows:

(a) a company limited by shares;

(b) a company limited by guarantee; or

(c) a company limited by both shares and guarantee;[84] or

(d) an unlimited liability company.

8.3 The CLRC believes that the present classification of companies according to the liability of members is sufficient in the present business environment and recommends its retention.

RECOMMENDATION:

8.4 The CLRC recommends that the present classification of a company according to its members' liability on winding up be retained.

Question for Consultation:

Question 21:

Do you agree that the present types of companies that could be incorporated (i.e. company limited by shares, company limited by guarantee, and an unlimited liability company) are sufficient to cater to the present needs of the business community?

[84] With effect from 1 February 1986, section 14A of the Companies Act 1965 prohibits new companies to be incorporated as a company limited by both shares and guarantee.

B MINIMUM NUMBER OF MEMBERS AND DIRECTORS

8.5 The Companies Act 1965 prescribes the same minimum membership requirements for both public and private companies. At least two persons are required to subscribe their names in the Memorandum and Articles of Association of the company for the purposes of incorporation.[85] The Companies Act 1965 further prohibits a company from carrying on business with fewer than the statutory minimum of two members for more than 6 months.[86] In this case, the only exception provided in the Companies Act 1965 is a company whose issued shares are wholly held by a holding company,[87] or commonly known as a wholly-owned subsidiary.

8.6 However, in practice certain companies are structured such that in substance the entire economic interest and control is vested in one single person through the use of nominee shareholder(s) or where one member owns substantially all of the shares and the remaining member owns only one share so as not to breach the legal requirement.

8.7 The CLRC recommends that the law allows the formation of a single-member company. The CLRC believes that individual entrepreneurs to limit liability will promote the spirit of entrepreneurship especially amongst small businesses. The CLRC also notes that the recommendation is in line with the reform proposals of various comparable jurisdictions.

[85] Section 14(1) of the Companies Act 1965.
[86] Section 36 of the Companies Act 1965 further states that a person who is a member of the company during the time that it so carries on business after those six months and is cognisant of the fact that it is carrying on business with fewer than two members shall be personally liable for the payment of all debts of the company contracted during the time.
[87] Section 5B of the Companies Act 1965 states that 'a corporation shall be deemed to be wholly-owned subsidiary of another corporation if none of the members of the first mentioned corporation is a person other than—
(a) the second-mentioned corporation;
(b) a nominee of the second-mentioned corporation;
(c) a subsidiary of the second-mentioned corporation, being a subsidiary none of the members of which is a person other than the second-mentioned corporation or a nominee of the second-mentioned corporation; or
(d) a nominee of such a subsidiary.'

8.8 At present, every company must have at least 2 directors each of whom must have his principal or only place of residence within Malaysia.[88] The Companies Act 1965 expressly states that a director of a company shall not resign or vacate his office if, by doing so the number of directors is reduced to below 2.[89] The same required minimum number of directors applies to both public and private companies.

8.9 In some comparable jurisdictions only private companies are allowed to have single directors whilst public companies are still required to have more. In other jurisdictions, the listing rules of their respective stock exchanges prescribe the minimum number of directors for listed companies.

8.10 The UK Companies Act 1985, the Australian Corporations Act 2001[90] and the New Zealand Companies Act 1993[91] allow private companies to be formed by at least one subscriber. For public companies, the UK Companies Act 1985 requires companies to have at least two members and three directors. However, the UK is currently proposing to allow a single person to form both public and private companies.[92] The UK Companies Act 1985 requires all private companies to have at least one director and a sole member can also be the sole director,[93] whilst a public company must have at least three directors. The Australian Corporations Act 2001 allows a private company to have a single director whilst a public company must have at least 3 directors, 2 of whom must ordinarily reside in Australia.[94] New Zealand legislation states that each company must have at least one director.[95]

88 Section 122(1) of the Companies Act 1965.
89 Section 122(6) of the Companies Act 1965.
90 Section 114 of the Australian Corporations Act 2001.
91 Section 10 of the Companies Act 1993.
92 UK White Paper on Modernising Company Law, Volume I, Part II, para 6.2.
93 The UK has implemented these provisions following the Twelfth Directive of the EC which was issued on 21 December 1989 (89/667(EEC) 21 December 1989).
94 Section 201A(2) of the Corporations Act 2001.
95 Section 10 of the Companies Act 1993.

8.11 It was recommended by the CLRFC that it is sufficient for one subscriber to form a private company in Singapore. The CLRFC was of the view that that there was no longer any continuing policy reason to require private companies to have a minimum of two shareholders and two directors. Allowing private companies to be incorporated with a minimum of one member and one director would reduce the incorporation and maintenance costs. The proposals have been adopted and the Singapore Companies Act now allows for the formation of all companies by a single person.[96] Singapore has also allowed companies to have a single director who can also be the sole member.[97]

8.12 The CLRC recommends that a company be allowed to have a single director who must be a natural person of full age and who has his principal or only place of residence within Malaysia. The CLRC believes that the requirement for single directors to have their principal or only place of residence within Malaysia serves as an adequate safeguard in ensuring that directors are accountable for their companies.

RECOMMENDATIONS:

8.13 The CLRC recommends that:

(a) companies be allowed to incorporate with only a single member;

(b) both private and public companies should have at least one director, (who must be a natural person of full age and who has his principal or only place of residence within Malaysia); and

(c) a sole director may also be the sole member of the company.

[96] Section 17 of the Companies Act (Cap 50).
[97] Subsections 145(1) and (2) of the Companies Act (Cap 50) state that every company shall have at least one director who is ordinarily resident in Singapore and that only a natural person of full age and capacity shall be a director of a company.

Questions for Consultation:

Question 22:

Do you agree that the minimum number of members required for public and private companies be reduced to one?

Question 23:

Do you agree that the minimum number of directors should be reduced to one, and that the sole director may also be the sole member of the company?

C INCORPORATION AND REGISTRATION OF COMPANIES

THE NAME SEARCH AND RESERVATION PROCESS

8.14 A company cannot be incorporated using a name which exists or using a name which is too similar to an existing company. Prior to incorporating a company, persons intending to form such a company must apply to the Registrar to do a name search as to the availability of the name for the intended company and shall reserve the name.[98] If the Registrar is satisfied as to the *bona fides* of the application and that the name is one which is not identical to an existing company, undesirable or restricted,[99] the proposed name will be automatically reserved for a period of three months.[100] During the reservation period, no company shall be registered under the reserved name or one which too closely resembles the reserved name.[101] However, the reservation of a name does not in itself entitle an intended company to be registered by that name.[102]

98 Section 22(6) of the Companies Act 1965 further provides that such request must be made in a prescribed form (Form 13A).
99 In practice, the Registrar will reply to the applicant on whether or not the name is available and approved within 3 days of such request.
100 Section 22(7) of the Companies Act 1965.
101 Section 22(9) of the Companies Act 1965.
102 Section 22(10) of the Companies Act 1965.

8.15 The CLRC is aware of views that the mandatory name reservation process adds an unnecessary procedure prior to incorporation. The name reservation process was intended to enable a person who wants to incorporate but may not be capable of immediately fulfilling all the incorporation requirements. With the name reservation process, once the required documents are available, the incorporator would be able to use the name reserved. The name reservation process has also been perceived as a means to minimise the duplication of names or the use of similar names for a company where there could be issues related to passing-off or similar liability. However, the CLRC is of the view that the current mandatory name reservation process is not necessary. With the increasing use of ICT by SSM, it should be possible for the public to have immediate access to a directory of names of registered companies and names which are currently being reserved[103] to ensure that there is no duplication of names. This will expedite the incorporation process, provided the register is updated accurately and efficiently.

8.16 However, should incorporators want to reserve a name for a limited period during which no other company can be registered using the reserved name, they should be permitted to do so, but this should be optional and not mandatory. Such name reservation process will address the needs of parties who are interested to protect certain names prior to incorporation.

8.17 The CLRC also noted that the present reservation period of 3 months may need to be shortened so as not to unreasonably deprive any other interested person from using the name. Amongst comparable jurisdictions, Malaysia has the longest period of reservation with three (3) months, Australia and Singapore with two (2) months, and New Zealand with 20 working days.

[103] At present, although the directory of registered companies is readily available on the SSM's website, the directory of reserved names is available for viewing at SSM's offices only.

8.18 The CLRC also noted that the mandatory name reservation and registration procedures which relied on the Registrar to 'approve' or 'disapprove' a name have resulted in the Registrar being made a defendant in passing off actions and therefore potentially liable to the plaintiff. The reason for this is because of the perception that since the Registrar has the discretion to approve or refuse the name applied for; the Registrar is giving an assurance that nobody else has been using the name.

8.19 The CLRC is of the view that the onus to ensure that the proposed name is not prohibited, undesirable or too similar with that of an existing company be placed on the persons who intend to incorporate a company. The CLRC believes that the Registrar should not be made a party to a civil action involving passing off and that this could be avoided if clear provisions exist to exonerate the Registrar from liability similar to section 11A(8) of the Companies Act 1965.[104]

8.20 However, the CLRC believes that even if the proposed company is incorporated under the selected name by the incorporator, the existing power of the Registrar to refuse registration of a name which is undesirable or one which the Minister has directed the Registrar not to accept for registration[105] and the power to direct a company to change its name[106] on certain grounds including that the name of the company was similar to that of another company, or if in the opinion of the Registrar too closely resembles the name of an existing company at the time of incorporation should still be retained. A company should be prohibited from being registered if its name is identical to an existing company, is prohibited or undesirable, or if the Minister has directed the Registrar not to register such names. It should also be

[104] Section 11A(8) of the Companies Act 1965 exonerates the Registrar from liability by reason of error or omission arising from documents lodged electronically if the error or omission was done in good faith and in the ordinary discharge duties of the Registrar.
[105] Section 22(1) of the Companies Act 1965.
[106] Section 23(3) of the Companies Act 1965 provides that the Registrar has the power to direct a company to change its name and if so directed, the company must change its name within six weeks.

expressly stated (in the incorporation form) that the fact a company is registered using a name does not mean that the company is recognised as having any proprietary rights over the name. The CLRC is of the view that such a power is necessary especially where an opportunistic registration occurs[107] and recommends its retention.

RECOMMENDATIONS:

8.21 The CLRC recommends that:

(i) there is no need for a mandatory name reservation process; and that the register of reserved names should be made available to the public;

(ii) incorporators have the option to reserve a name, for a shorter period;

(iii) clear provisions should be provided in the Companies Act 1965 to exonerate the Registrar from liability similar to section 11A(8); and

(iv) the Registrar should retain the power to direct a name change.

CROSS JURISDICTIONAL STUDY

United Kingdom

8.22 There is no provision requiring the reservation of names in the Companies Act 1985. Section 26 of the Companies Act 1985 provides prohibitions on the registration of certain names and thus, the subscribers have the onus to ensure that the names are acceptable within the meaning of the section. The Secretary of State has the power to direct a change of name of a company, within 12 months of its incorporation, on

[107] Opportunistic registration occurs when:
- A person anticipating that a famous brand name is about to enter the market incorporates the company within the jurisdiction in the foreign company's name/brand name.
- A company name is registered in anticipation of a well-known company changing its name upon the completion of a merger or takeover.

the basis that it is identical to the name of an existing company appearing or which should have appeared at the register of companies at the time of its incorporation.[108]

Australia

8.23 There is no provision requiring reservation of names in the Corporations Act 2001. A company name is available if it is not identical with that of an existing company or unacceptable.[109] Notwithstanding, the Corporations Act 2001 allows for the option of reserving a name if the name is available.[110] The name of a company can be reserved for a period of two months with a further extension period of 2 months. ASIC has the power to direct a company to change its name if it is identical with that of an existing company or unacceptable. Within 2 months of such a directive, a company must change its name. If a company fails to do so, ASIC will change the company's name to its Australian Company Number (ACN).[111]

New Zealand

8.24 At present, the New Zealand Companies Act 1993 provides for mandatory name reservation, where the Registrar will not register a company unless the name has been reserved.[112] An application for the reservation of names will be replied to within several days but online reservation is normally replied to within minutes. A name can be reserved for 20 working days. The Registrar has the power to direct a company to change its name on the grounds of the name being identical with that of an existing company. The company must comply with the directive within 20 working days, otherwise the Registrar will enter a new name for the company in the register of companies.[113]

[108] Section 28(2) of the Companies Act 1985.
[109] Section 147 of the Corporations Act 2001.
[110] Section 152 of the Corporations Act 2001.
[111] Section 158 of the Corporations Act 2001.
[112] Sections 20 and 22 of the Companies Act 1993. Application for reservation of a name is made through Form 4.
[113] Section 22 of the Companies Act 1993.

Singapore

8.25 The Companies Act (Cap 50) does not require names to be reserved prior to incorporation. A company is prohibited from being registered if its name is identical to that of an existing company, undesirable, or if the Minister has directed the Registrar not to register such names.[114]

8.26 However, the option to reserve a name is still retained and during the reservation of a name, no other companies can be registered. Reservation is allowed for 60 days after which the name can be further reserved for a further period of 2 months.[115]

8.27 The Registrar has the power to direct a company to change a name if the name resembles or is identical with that of an existing company at the time of incorporation.[116] Notwithstanding, the CLRFC has proposed the adoption of the UK's provision to empower the Registrar to direct a change of name on its own initiative or upon receipt of valid complaints that are filed within 12 months of incorporation.[117]

Questions for Consultation:

Question 24:

Do you agree that the name reservation process should not be made mandatory but should be made optional?

Question 25:

Do you agree that the current position where the Registrar is authorised to direct a change of name should be retained?

[114]Section 27 of the Companies Act (Cap 50).
[115]Section 27(12) and (13) of the Companies Act (Cap 50).
[116]Section 28(3) of the Companies Act (Cap 50).
[117]The Company Legislation and Regulatory Framework Committee Report, para 4.4.1.

SIMPLIFICATION OF INCORPORATION PROCESS

8.28 At present, persons intending to incorporate a company must lodge with the Registrar the following documents:[118]

- Memorandum and Articles of Association (if any) of the Company
- Form 6 – a declaration of compliance by the first secretary of the company (together with a copy of his identity card)
- Form 48A – a declaration by each director (together with a copy of their identity cards)
- Form 46 – applicable to public companies only, an undertaking by directors to take and pay for qualification shares applicable, if any.

8.29 All the above documents must be accompanied by a cover letter, together with a copy of the name approval (Form 13A).

8.30 To simplify a company's incorporation, the CLRC believes that the information contained in various documents should be consolidated into a single form.[119] Notwithstanding, documents which are currently required to be lodged would still be necessary, for example the company's Memorandum and Articles of Association or certain other prescribed forms such as Form 46.

8.31 The CLRC's recommendation in relation to fully utilising ICT to expedite the incorporation process using electronic means is set out in the later part of this Consultative Document.

[118] Section 16 of the Companies Act 1965.
[119] The prescribed form may contain information regarding details of all directors of proposed directors, share capital structure, registered office address and opening hours, type of entity formed etc.

STATUTORY DECLARATIONS

8.32 At present, there are many instances[120] where the Companies Act 1965 requires the making and filing of the statutory declarations with the Registrar.[121] The statutory declaration must be executed according to the Statutory Declarations Act 1960, or if executed outside Malaysia, it has to be in accordance to the law relating to oaths and declarations of that particular place or country.[122] Section 3 of the Statutory Declarations Act 1960 provides that a false declaration is punishable under the Penal Code.[123]

8.33 The CLRC noted that the purpose of statutory declarations is to increase awareness and act as a caution to a person against making a false statement. However, the CLRC noted that the requirement for statutory declarations in some of the provisions of the Companies Act 1965 may create problems in an electronic environment.

8.34 The CLRC recommends that a statutory declaration be replaced with a statement of compliance[124] as with the UK approach. The Registrar may accept such statement as sufficient evidence of compliance. The value of the statement of compliance as a precaution against false statement is still retained as section 364 of the Companies

[120] In some circumstances, a statutory declaration is not required under the Companies Act 1965 but required under the Companies Regulations 1966 such as in Form 43 containing a declaration verifying the memorandum of satisfaction of charge for the purpose of section 113(2).

[121] Amongst others, statutory declarations must be executed and to be lodged in the following situations:
(i) pursuant to section 16(3A), subscribers are required to lodge with the Registrar and Official Receiver that they are not disqualified under to sections 125 and 130 of the Companies Act 1965.
(ii) pursuant to section 123(4), before any person is appointed as a director (either as first director or subsequent directors.
(iii) pursuant to section 169(16), by a director or person primarily in charge of financial management of a company to accompany the financial statements to be laid before a general meeting.
(iv) pursuant to section 332(g), by an agent of a foreign company wanting to establish or carry on business within Malaysia.

[122] Regulations 17(2) of the Companies Regulations 1966.

[123] Sections 199 and 200 of Penal Code provides that false statements made in any declaration which is by law receivable as evidence and whoever makes or uses as true, any such declaration known to be false shall be punishable with imprisonment for up to three (3) years and a fine.

[124] See sections 12(3), 12(3A) and 30(5A) of the UK Companies Act 1985. Section 12(3) states that 'Subject to subsection (3A), a statutory declaration in the prescribed form by (a) a solicitor engaged in the formation of a company, or (b) a person named as a director of the company in the statement delivered under section 10(2) that those requirements have been complied with shall be delivered to the Registrar of Companies, and the Registrar may accept such a declaration sufficient evidence of compliance. In an electronic filing environment, the statement may be delivered to the Registrar using electronic communications which has the effect that the requirements in relation to a statutory declaration has been complied with.

Act 1965 provides adequate measure to deter a company or any officer from submitting false and misleading statements to the Registrar without the need to require a sworn statement.[125]

D CERTIFICATES OF INCORPORATION

8.35 Upon registering the incorporation documents, the Registrar will register the company. Once registered, a certificate of incorporation will be issued and the company will also be issued with a company number.

8.36 The CLRC believes that the issuance of certificates of incorporation still serves its purpose as a source of identification and/or as evidence of the formation of companies and recommends its retention.

COMPANY SEALS

8.37 Once incorporated, a company must have a common seal.[126] As a company is an artificial entity without a physical presence, it acts through its board of directors when carrying out activities including entering into various transactions, contracts or agreements.[127] A company seal is used for the purposes of a company's business and represents its signature. The manner in which a company's common seal is to to be used is provided under the company's Memorandum and Articles of Association.[128]

[125] The CLRC noted that the penalty provision in section 364 of the Companies Act 1965 is stricter compared to that found under the Penal Code. An offence under section 364 of the Companies Act 1965 carries a penalty of imprisonment for ten (10) years or RM250,000 whereas sections 199 and 200 of Penal Code provides that false statements made in any declaration which is by law receivable as evidence and whoever using as true any such declaration known to be false shall be punishable with imprisonment for up to three (3) years and a fine.

[126] Section 16(5) of the Companies Act 1965.

[127] At present, the following actions or documents require the affixation of common seal:
(i) a contract on behalf of a company which if made between private persons must be made in writing under seal;
(ii) a power of attorney to execute deeds on behalf of the company; and
(iii) the issuance of share certificates under the common seal of the company as *prima facie* evidence of the title of the member to the shares of the company.

[128] Article 96, Table A, Fourth Schedule of the Companies Act 1965 states that a director shall provide a safe custody of the common seal, which shall be used by the authority of the directors or committee of the directors authorized by the directors in that behalf, and every instrument to which the seal is affixed shall be signed by a director and shall be countersigned by the secretary or by a second director or by some other person appointed by the directors for that purpose.

8.38 The CLRC believes that the requirement for companies to have a common seal still has its significance in the companies' day-to-day operations in view of the requirements of other laws[129] and recommends its retention.

RECOMMENDATIONS:

8.39 The CLRC recommends that:

(i) to simplify the incorporation process, a single incorporation document in a prescribed form should be introduced;
(ii) the requirement for a statutory declaration be replaced with a statement of compliance;
(iii) the issuance of certificates of incorporation of companies be retained; and
(iv) the requirement for companies to have a common seal be retained.

CROSS JURISDICTIONAL STUDY

United Kingdom

8.40 To simplify incorporations, the UK Company Law Review[130] had proposed that information be consolidated into a single prescribed form. This information may be divided into two parts:

- Firstly, basic information such as the name and type of company and jurisdiction of incorporation; and

[129] For example, the National Land Code.
[130] Modern Company Law: Company Formation and Capital Maintenance, October 1999.

- Secondly, information that may be changed including names and addresses of founder members, directors and company secretaries; the intended address of the intended company, the amount of share capital initially subscribed (for companies limited by shares) and the amount of guarantee of each member (for companies limited by guarantee).

8.41 It was also proposed that the statutory declarations required from the subscribers, directors or company secretaries be dispensed with and replaced by a declaration of compliance. The Review had also proposed the retention of provisions for a certificate of incorporation as conclusive evidence that the company has been registered and existed as a separate legal entity. The above proposals were endorsed by the UK Government in July 2002.[131]

8.42 The UK Companies Act 1985 no longer requires a company to have a common seal.[132]

Australia

8.43 Section 117 of the Corporations Act 2001 requires the registration of a company to be made in a prescribed form containing information including the name and type of company, name and addresses of the members, directors and company secretary, the address, opening hours of the proposed company. If the company is to be a public company and is to have a constitution on registration, a copy of the constitution must be lodged with the application.

8.44 The Corporations Act 2001 does not require statutory declarations from subscribers, directors or the company secretary. This requirement is replaced by one where at the

[131] White Paper 'Modernising Company Law: The Government's Policy', July 2002 at para 6.2.
[132] Section 36A of the Companies Act 1985.

point of incorporation an applicant must have received consent in writing from people who have agreed to be the members, directors and company secretaries of the company. After incorporation, these consents in writing must be kept by the company.

8.45 The Corporations Act 2001 still retains provisions for the certificate of incorporation as conclusive evidence that a company has been incorporated. The Corporations Act 2001 provides for lodgement to be made electronically, provided that there is consent in writing between ASIC and the person wanting to lodge such documents.[133]

8.46 The Corporations Act 2001 does not require companies to have common seals, but if a company has a common seal, the common seal must bear the company's name and the company's number. Sections 126 and 127 of the Corporations Act 2001 specially mentioned that a company may enter into contracts or transactions without the use of a common seal.

New Zealand

8.47 In New Zealand, the incorporation documents and information required are similar to the Malaysian provisions except that no statutory declarations are required from the subscribers or directors.[134] The requirement for statutory declarations has been replaced by one for a statement of consent in a prescribed form.

[133] Section 352 of the Corporations Act 2001.
[134] The present requirements of New Zealand Companies Act 1993 requires the following documents for incorporation purposes:
(a) a prescribed form to be signed by each applicant;
(b) a document in the prescribed form signed by every person named as a director, containing his or her consent to be a director and a certificate that he or she is not disqualified from being appointed or holding office as a director of a company;
(c) a document in the prescribed form signed by every person named as a shareholder, or by an agent of that person authorised in writing, containing his or her consent to being a shareholder and to taking the class and number of shares specified in the document; and
(d) accompanied by a notice reserving a name for the proposed company; and
(e) if the proposed company is to have a constitution, accompanied by a document certified by at least one applicant as the company's constitution.
Additionally, the information must also be furnished in respect to full name and address of each applicant; the full name and address of each director; the full name and address of each shareholder; the registered office of the proposed company and the address of service of the proposed company.

8.48 At present, the New Zealand Companies Act does not contain provisions relating to electronic incorporations and filings. Similarly, the New Zealand Company Law Reform and Restatement also dispensed with the requirement for companies to have a common seal.[135]

Singapore

8.49 The Singapore Companies Act (Cap 50) had recommended streamlining of the incorporation process in order to reduce incorporation costs and facilitate same-day incorporations. The CLRFC has recommended that the filing documents be consolidated to eliminate duplication. Specifically, the CLRFC recommended the consolidation of incorporation forms into a single form that is electronically submitted to the Registry of Companies and Businesses.

8.50 With the implementation of e-filing in January 2002, the Singapore Companies Act removed the need for a statutory declaration. Instead, a declaration of compliance needs to be made before a defined professional. In the case of e-filing, directors or company secretaries need to give their consent through a specified PIN number. However, the CLRFC had recommended the dispensation of a declaration in writing and for the form to be signed before a defined professional. The directors or company secretaries would indicate their consent electronically using the PIN number which would serve as a secure and unique verification of his identity. For directors (or company secretaries) who elect to go through professional agents, it shall be the duty of the agents to verify and confirm the identities, qualifications and consents of these persons. Section 19(2) of the Singapore Companies Act has since been amended accordingly.

[135] Report No 9, June 1989 at para 96.

8.51 With effect from 13 January 2003, a certificate of incorporation will no longer be issued to confirm that a company is incorporated. Instead, an official notification will be given *via* e-mail to confirm an incorporation of a company. Notwithstanding, a company may apply to the Registrar for a hardcopy of the incorporation certificates.

8.52 The Singapore Companies Act still retains the requirement for a company seal.

Questions for Consultation:

Question 26:

Do you agree that the present incorporation documents should be simplified and consolidated into a single prescribed form?

Question 27:

Do you agree that with the exception of a statutory declaration prior to the appointment as directors or secretaries, the requirement for a statutory declaration should be replaced by a declaration of compliance?

Question 28:

Do you agree that the incorporation certificate should be conclusive evidence that a company named in it had been registered and exists as a separate legal person?

Question 29:

Do you agree that the requirement for a company to have a common seal under the Companies Act be retained?

E FACILITATING ELECTRONIC INCORPORATION AND ELECTRONIC FILING/LODGEMENT OF DOCUMENTS

8.53 The CLRC agrees that information and communication technology (ICT) should be utilised to enhance the efficiency of companies' administration. This part of the Consultative Document focuses on whether or not the present legal framework is sufficient to facilitate the use of ICT in an electronic filing environment.

8.54 Currently, section 11A of the Companies Act 1965 allows the Registrar to provide a service for electronic filing or lodgement of documents. Section 11A also allows the Registrar to set the conditions and guidelines for the purpose of providing such service including prescribing the appropriate subscription fees. Further, it is stated in section 11A that only subscribers to the service can file or lodge documents electronically.

ELECTRONIC FILING AS AN ALTERNATIVE TO PAPER FILING

8.55 Whilst the Companies Act 1965 allows the filing or lodgement by electronic means by subscribers to the service, it does not specify the types of filing or documents to be lodged.

8.56 The CLRC noted the importance of electronic filing as a tool to enhance the efficiency of filing or lodgement of documents. The CLRC also noted that the migration towards electronic filing environment could be carried out in two ways:

(i) by way of a hybrid filing process which allows subscribers to the e-filing service to lodge documents electronically whilst those who have not chosen to be a subscriber can still utilise the paper filing system,[136] or alternatively

[136] SSM may prescribe documents that can be filed electronically by subscribers where they are allowed to choose either to file them by way of e-filing or paper filing. Alternatively, SSM may prescribe documents that must be filed electronically.

(ii) by way of a mandatory electronic filing process which requires companies to use the e-filing services for the purposes of lodgement or filing of all documents.

8.57 To enhance the process of lodgement or filing of documents as well as ensuring its currency, the CLRC recommends that all documents should be filed electronically.

8.58 The CLRC also recommends that a transitional period be allowed before full migration takes place to allow the public to be familiar with the new system.

SIGNATURE AND ATTESTATION OF WITNESSES

8.59 The CLRC also noted that amongst the challenges faced by electronic filing would be the signature and attestation requirements, as the Companies Act 1965 requires certain documents to be signed and attested prior to being filed or lodged with the Registrar. These include requirements pursuant to section 18(2) where subscribers to a Memorandum of Association are required to sign the Memorandum of Association and have at least one witness to attest their signature, and pursuant to section 123(1)(a) - (d) of the Companies Act 1965 that requires a director to sign certain documents and have his signature attested prior to his appointment as director.

8.60 Presently, section 11A(6) states that a document that is required to be stamped, signed or sealed, if it is to be electronically filed or lodged, shall be certified or authenticated in such a manner as may be prescribed by regulations or approved by the Registrar. In addition, the Digital Signature Act 1997 (DSA 1997) also recognises the validity of a document if it is signed with a digital signature in accordance to its provisions.[137] The DSA 1997 also allows the appointment of licensed certification

[137] The digital signature is defined under the DSA 1997 as the 'transformation of a message using an asymmetric cryptosystem such that a person having the initial message and the signer's public key can accurately determine whether the transformation was created using the private key that corresponds to the signer's public key and whether the message has been altered since the transformation".

authorities[138] whose function[139] is to authenticate electronic transactions.

8.61 Based on the above, the CLRC recommends that provisions relating to the attestation of signature be amended by deleting the requirement for attestation where documents are signed electronically.

REGISTRAR TO UTILISE ELECTRONIC SERVICES

8.62 Although section 11A allows the Registrar to provide for services that allow documents to be filed or lodged electronically, it is not clearly stated that the Registrar can utilise such electronic services to facilitate communication with users.

8.63 The CLRC recommends that section 11A should be amended to allow the Registrar to utilise such electronic services including the issuance of orders, notices, certificates and others to users. It is also recommended that the definition of 'documents' under section 4(1) of the Companies Act 1965 be amended to reflect such changes.[140]

RE-LODGEMENT OF LOST DOCUMENTS

8.64 Under the present paper filing environment, section 13(2A) of the Companies Act 1965 empowers the Registrar to request the re-lodgement of documents which he reasonably believes have been lost or destroyed. A corporation is given 14 days after

[138] A Certification Authority is the body given the licence under the DSA 1997 to operate as a trusted third party in the issuance of digital certificates and which is supervised by the Malaysian Multimedia and Communication Commission.

[139] Section 6 of the DSA 1997 states:
(1) The function of a licensed certification authority shall be to issue a certificate to a subscriber upon application and upon satisfaction of the licensed certification authority's requirements as to the identity of the subscriber to be listed in the certificate and upon payment of the prescribed fees and charges.
(2) The licensed certification authority shall, before issuing any certificate under this Act, take all reasonable measures to check for proper identification of the subscriber to be listed in the certificate.
(3) The licensed certification authority shall, on the issuance of any certificate under this Act, cause the application for the certificate to be certified by a notary public duly appointed under the Notaries Public Act 1959 [Act 115].

[140] At present, section 4(1) of the Companies Act 1965 defines 'documents' to include summons, order and other legal process, and notice and register. The Singapore Companies Act (Cap 50) has redefined 'documents' to include 'any application, form, report, certification, notice, confirmation, declaration, or other document to be filed or lodged with or submitted to the Registrar or, as the case may be, any certificate, notice or other document to be issued by the Registrar'. SSM has proposed that the Singapore definition be adopted and it is now being considered by the Ministry.

the service of the notice by the Registrar to re-lodge the documents or any such longer period that the Registrar may specify. However this power is limited to cases when the documents are believed to have been lost or destroyed.

8.65 In Australia, a signed copy of the document must be held by the person lodging the document and must be made available by the person to ASIC if it so requires. Some documents may also be viewed and changed as to their contents electronically. Companies may also electronically lodge annual returns and pay fees online. This is done by using personal identification numbers (PINs) for authentication.

8.66 In Singapore, despite the fact that electronic filing is now mandatory, where Forms 45 and 45A relating to director's consent are concerned, the law still requires that the hard copy of the consent, signed by the director be kept at the company's registered office.

8.67 The CLRC recommends that a similar provision as found in the Australian Corporations Act 2001 be provided in requiring a person lodging a document to keep a copy of the document, which must be made available to the Registrar if he so requires.

LIABILITY OF REGISTRAR

8.68 One important area of concern is the liability of the Registrar. The existing section 11A(8) of the Companies Act 1965 provides for protection to the Registrar against any loss or damage suffered by any person who obtains the documents which were electronically filed or lodged under subsection 11A(1) due to any error or omission of whatever nature and howsoever arising if the error or omission was made in good

faith and in the ordinary course of the discharge of the Registrar's duties or occurred or arose as a result of any defect or breakdown in the service or equipment used for the provision of the service.

8.69 The CLRC noted the importance of section 11A(8) of the Companies Act 1965 and recommends its retention.

RECOMMENDATIONS:

8.70 The CLRC recommends that:

(a) electronic filing or lodgement of documents be made mandatory. However, a transitional period should be allowed to enable migration towards full electronic filing;

(b) provisions relating to the attestation of signatures be amended by deleting the requirement for attestation where documents are signed electronically;

(c) section 11A of the Companies Act 1965 be amended to allow the Registrar to utilise such electronic services including the issuance of orders, notices, certificates and other to users and that the definition of 'documents' under section 4(1) of the Companies Act 1965 be amended accordingly;

(d) a person lodging a document electronically must keep a copy of the document and this must be made available to the Registrar, if so required; and

(e) the present arrangement under section 11A(8) be retained, to protect the Registrar against any loss or damage suffered by any person who obtains the documents which were electronically filed or lodged due to any error or omission of whatever nature and howsoever arising if the error or omission was made in good faith and in the ordinary course of the discharge of the Registrar's duties or if it occurred or arose as a result of any defect or breakdown in the service or equipment used for the provision of the service.

CROSS JURISDICTIONAL STUDY

United Kingdom

8.71 The United Kingdom has adopted electronic filing since 1998 as an alternative to paper filing. The use of ICT for the purpose of electronic filing has been further enhanced through the Companies Act 1985 (Electronic Communications) Order 2000. Section 107B states that electronic communications may be used for the delivery of any document to the Registrar under any provision of the Companies Act (including delivery of a document in the prescribed form), provided that such delivery is in such form and manner as is directed by the Registrar.

8.72 References to the delivery of a document include references to the forwarding, lodging, registering, sending or submission of a document and to the giving of a notice, and cognate expressions are to be construed accordingly.

8.73 Various amendments to the UK Companies Act 1985 to further facilitate the electronic filing environment have been made. These include replacing statutory declarations with statements of compliance, and replacing the signature and attestation requirements with an electronic equivalent where a personal authentication code is used.[141] Further, provisions are also in place to ensure that lodged documents are reliable.

[141] Section 2(6A) of the UK Companies Act 1985 provides that 'where the memorandum is signed electronically by each subscriber, the requirement in subsection (6) for attestation of the signatures does not apply'. Further, section 7(3A) states that 'where the articles are signed electronically by each subscriber of the memorandum, the requirement in subsection (3)(c) for attestation of the signatures does not apply'.

Australia

8.74 Section 352 of the Corporations Act 2001 allows documents to be lodged electronically. However, a document can only be lodged electronically if the person seeking to lodge the documents has an agreement with the ASIC in writing to lodge such documents *via* electronic means. The document is taken to be lodged with ASIC if it is lodged in accordance with the agreement or approval (including any requirements of the agreement or approval as to authentication).[142]

8.75 In addition, the ASIC has the power to determine the conditions in relation to the electronic lodgement of documents.[143] The Electronic Transactions Act 1999 provides that an electronic signature will be recognised as equivalent to a handwritten signature provided that certain conditions are met.[144]

New Zealand

8.76 The New Zealand Companies Act 1993 allows the Registrar to keep registers electronically and empowers him to refuse any lodgement of documents that cannot be entered directly by electronic or other means or device or facility. The Companies Act 1993 is silent in regard to electronic signature, attestation etc.

8.77 To reduce uncertainty regarding the legal effect of information that is in electronic form or that is communicated by electronic means the New Zealand Electronic Transactions Act (ETA) 2002 was passed, facilitating the use of electronic technology, The ETA 2002 is applicable to all laws in New Zealand including those which have been enacted before its commencement.[145]

[142] Section 352 of the Corporations Act 2001.
[143] Section 353 of the Corporations Act 2001.
[144] Section 10 of the Electronic Transactions Act 1999 stipulates the method used must meet the following conditions:
(a) It identifies the person and indicates his approval; and
(b) It is reliable and appropriate for the purposes for which the information is communicated at the time the method is used.
[145] Section 3 of the New Zealand Electronic Transactions Act 2002.

8.78 The ETA 2002 clarifies that certain paper-based legal requirements may be met by using electronic technology that is functionally equivalent to those legal requirements including the requirement for electronic signature, seal, declaration and witnesses.[146]

Singapore

8.79 Section 12A of the Singapore Companies Act (Cap 50) allows electronic filing which promotes a paperless environment. The electronic service is available for documents lodged with and issued by the Registrar. Similar to the United Kingdom, the Companies Act (Cap 50) has been amended to facilitate electronic filing, including dispensing with the requirements for statutory declaration, signature and attestation. These have been replaced with statements of compliance and PINs.

Question for Consultation:

Question 30:

Do you agree that electronic filing and lodgement of documents be made mandatory?

[146] Sections 14 to 32 of the New Zealand Electronic Transactions Act 2002.

Section D

Survey of Company Directors' Views on Statutory Audit

SURVEY OF COMPANY DIRECTORS' VIEWS ON STATUTORY AUDIT

Working Group A
Corporate Law Reform Committee

23 February 2006

SECTION D - SURVEY OF COMPANY DIRECTORS' VIEWS ON STATUTORY AUDIT

EXECUTIVE SUMMARY

The Companies Act 1965 mandates companies registered under the Act to submit annual audited accounts to the Companies Commission of Malaysia (SSM). The 1965 statutory requirement is now under review by the Corporate Law Reform Committee of SSM to consider amendments to the Act with the objective of promoting business growth and creating a sustainable business environment for private limited companies to operate in Malaysia.

This study, commissioned by the Corporate Law Reform Committee of the SSM, examines factors of costs and benefits relating to statutory audit as a basis for making policy decisions on the existing requirements of the Act which requires mandatory submission of audited financial statements by private limited companies in Malaysia.

The primary objective of this study is to determine the extent to which directors of unlisted, private limited companies, in particular the small and medium sized entities (SMEs), perceive the value of financial audit to their companies. This study also examines the perceived costs associated with the statutory audit which have been presumed to be of concern among directors of SMEs. In the process, it explores factors behind directors' motivation to carry out audit for their companies and attempts to challenge or strengthen the findings by analyzing the propensity of directors to conduct financial audit on a voluntary basis if the government was to remove the statutory requirement for audit.

This study involved mail survey of 2300 directors of unlisted, private limited companies. A total of 407 directors responded, representing an 18 percent response rate, statistically sufficient to provide meaningful deductions of findings at 95 percent confidence to enable the CLRC to make appropriate recommendations for SSM.

The main findings of the study are summarized below:

Overall

Overall, a large majority of directors of unlisted, private limited companies and SMEs in Malaysia have found the financial audit of the accounts of their companies to be:

- beneficial
- necessary, and
- a worthwhile exercise.

Audit is beneficial

The findings show that an overwhelming majority (82%) of directors find audit to be beneficial.

- 56% of directors says audit is beneficial or very beneficial
- 26% says audit is somewhat beneficial
- 18% says audit is not beneficial

The directors are of the view that audit has brought many benefits to their companies. They indicated, in the order of priority, that:

- the audit has provided assurance to banks and financial institutions
- the audit has improved the company's record keeping
- the audit has provided assurance to suppliers, and
- the audit has improved systems of internal control

Audit is necessary

The findings also show that an overwhelming majority (77%) of directors find audit to be necessary. They believe that it is necessary for audit to be made mandatory.

When the directors are asked about how necessary it is for financial audit to be made mandatory,

- 54% of directors says it is necessary to make audit mandatory
- 23% says it is somewhat necessary to make audit mandatory
- 23% says it is not necessary to make audit mandatory

Audit is a worthwhile exercise

Recognising the above benefits, the directors indicated that audit is a worthwhile exercise for their company. The overwhelming support for this view is further evidenced by the motivation for them to carry out the audit voluntarily, even if the law does not mandate them to do so. Statistically,

- 71% of directors says they would carry out the audit voluntarily
- 29% of directors says they would not, if they were given the choice.

When asked to explain why they would still conduct the audit despite not being compelled to do so, the directors indicated that the primary motivations behind doing audit are:

- for corporate governance, transparency and accountability (39%)
- for internal control (34%)
- for financing and tax filing (20%)
- for various other reasons (7%)

Costs

Costs of audit have been presumed to be the directors' concern. The findings, however, show that such concern has not been as overwhelming as the benefits derived from the audit.

Directors of private limited companies are impartial when asked about how prohibitive the cost is, relative to the size of their companies. For example, the following statistics show the directors' view about the cost of audit:

Strongly agree or agree that cost of audit is high	48%
Impartial / neutral	37%
Strongly disagree or disagree that cost of audit is high	15%

Costs vs. benefits

The directors seem to find the benefits outweigh the costs of carrying out the financial audit. They find the value of audit is embedded in corporate governance and internal control and that it is necessary for banking facilities. Generally, they believe that the financial audit is a worthwhile exercise.

Recognising these benefits, they indicated that they are prepared to continue with the financial audit irrespective of whether or not it is imposed upon them.

It is also interesting to note that concerns over costs of audit have not been as alarming as were initially anticipated. Perhaps, the directors are of the view that audit-related costs are manageable. After all, a majority of these companies may have engaged external auditors to assist them in tax and secretarial services and auditing the accounts, alleviating the need for them to employ, train and allocate more staff than necessary to handle the accounting functions. In the past, the audit costs might have been managed favourably and the quantum determined through negotiations between SMEs and the audit firm engaged to do the audit.

Options

The above findings bring important implications for policy makers. The regulators have several options:

First: Maintain status quo

SSM can maintain its present policy on statutory audit on accounts and filing of such audited accounts. The fact that SMEs have found benefits to financial audit and are prepared to carry out the audit voluntarily indicates the level of propensity for them to continue with the audit of the accounts. They have been filing audited accounts, and presumably would not hesitate to continue filing the audited accounts in the future if that is required under the law.

Second: Exempt SMEs from filing audited accounts

The ultimate objective of the company law reforms is to create a climate for businesses to flourish by simplifying procedures as well as by reducing costs and bureaucracies. Exempting SMEs from filing accounts that are audited is a choice that can meet such an objective.

Exemption can be in the form of removing the legal requirement to submit the audited accounts while continuing to mandate submissions of a statement by directors about company solvency. This would be similar to the privilege accorded to exempt private companies.

This option will reduce the burden on SMEs of having to file their audited accounts with SSM but at the same time will allow SSM to continue to maintain records on the financial position of the SMEs.

Third: Exempt SMEs from audit and filing of accounts

The third option is to lift the requirement of audit by SMEs and to exempt them from filing their accounts. This option assumes SMEs would carry out the audit of accounts voluntarily driven by motivations discussed above. This option means that SSM will no longer have control over any record of the financial positions of SMEs.

Introduction

This study was commissioned by the Companies Commission of Malaysia (SSM) to explore the costs and benefits of statutory audit on companies in Malaysia. The focus is primarily on the small and medium sized entities (SMEs) as part of the initiatives of the corporate law reform to create a more favorable business climate for SMEs to grow and prosper by either removing barriers that hamper the development of or introducing incentives to SMEs in Malaysia.

This paper is prepared by a group of consultants appointed in January 2005 by the SSM to investigate issues in connection with the benefits and costs associated with the existing mandatory filing of statutory audits by SMEs by examining the views of directors of unlisted, private limited companies.

The views of the directors are necessary as SMEs represent a substantially large proportion of companies registered in Malaysia. Their opinions are important as there have been very few up-to-date empirical research findings to understand how directors of SMEs in Malaysia perceive the value of the audit of their accounts and whether cost of audit is a factor that regulators should consider in making policy decision on SMEs.

As at 31 December 2004, there are a total of 689,000 registered companies in Malaysia. These companies have to submit audited financial statements to the SSM annually except for exempt private companies. As at that the end of 2004, there is an unconfirmed figure of 65,500 exempt private companies or 9.5% of the total universe of registered companies. In other words, 90.5% of companies in Malaysia is required under the law to audit and file

audited financial statements to the SSM. Among the companies that must file audited accounts, a significantly large majority are small and medium sized entities that fall within the definition of small and medium sized entities such as:

- Total revenue of not more than RM25,000,000
- Total assets of not more than RM10,000,000
- Number of employees of not more than 150

The question of whether differential treatment for audit should be accorded to SMEs has come to light in the past through anecdotal discussions in various forums and had resurfaced currently in view of the current corporate law reform exercise. The question of differential treatment is also timely in light of a wider debate in the international accounting community on the need for different sets of financial reporting standards for publicly listed companies and SMEs. There is currently an ongoing high-level discussion at the International Accounting Standards Board on the need, form and content of the accounting standards for SMEs.

Audit of Financial Statements

Audit of financial statements is an integral part of corporate governance. The audit provides assurance interests outside of management as to the accuracy, validity and faithfulness of financial statements prepared by the management. Detection of fraud lies outside the scope of audit. However, the consequential outcome of audit has generally translated into managerial and organisational benefits such as effective internal control, better record keeping, and operational efficiency.

Cost of audit to companies of varying sizes is commonly associated with the audit of financial statements. In Malaysia, the minimum fees chargeable for basic audit of accounts ranges from a minimum of RM300 to a few hundred thousand ringgit depending of the complexity and depth of audit. Some may argue that such cost, and therefore audit, is unnecessary for small, owner-manager companies whose reporting and accountability responsibility does not extend beyond the owners and family members. Others may have argued that such cost, when gauged against potential benefit accruing from the audit, is justifiable.

Statutory Audit

Section 169 of the Companies Act 1965 mandates filing of audited financial statements to SSM on a timely basis. The Act also requires all registered companies, except for private exempt companies, to submit to the SSM annual audited accounts prepared in accordance with approved accounting standards. Notwithstanding the relief accorded to the private exempt from filing audited accounts to the SSM, the Eighth Schedule of the Companies Act requires private exempt companies to lay before the annual general meeting their audited accounts.

Over the last four decades since the statutory audit was first introduced, companies have continued to grow in number and have practically ascribed to the filing of audited financial statements annually in their practice.

Definition of Small, Medium and Large Sized Companies

In Malaysia, there has not been a conclusive definition of small and medium sized entities. The closest formal evidence is the one found in Small and Medium Industries Development Corporation (SMIDEC) document and the Malaysian Accounting Standards Board technical pronouncement.

SMIDEC describes SMEs into two broad categories: manufacturing and services. It further categorises them into micro, small and medium industries. These classifications are reproduced below:

	Category	Micro-Enterprise	Small Enterprise	Medium Enterprise
1	Manufacturing, Manufacturing-Related Services and Agro-based industries	Revenue of less than RM250,000 OR full time employees less than 5	Revenue between RM250,000 and less than RM10 million OR full time employees between 5 and 50	Revenue between RM10 million and RM25 million OR full time employees between 51 and 150
2	Services, Primary Agriculture and Information & Communication Technology (ICT)	Revenue of less than RM200,000 OR full time employees less than 5	Revenue between RM200,000 and less than RM1 million OR full time employees between 5 and 19	Revenue between RM1 million and RM5 million OR full time employees between 20 and 50

The Malaysian Accounting Standards Board (MASB) defines size of companies in the context of financial reporting obligation. It does not define what SMEs are but lays down criteria of an entity that may be exempted from complying with provisions of the financial reporting standards. Such an entity is called an 'exempt entity'.

An entity is an 'exempt entity' if:

1. it does not have public accountability. Public accountability is deemed to exist where the entity has obtained or seeks funding from the public, or where it has significantly large number of stakeholders who base their resource allocation upon their knowledge of the entity, or when it possesses certain authority to impose levy or tax to obtain public funds.

2. all of its owners are members of the governing body of the entity, and

3. it is not large. Large is an attribute of an entity having exceeded two of the following criteria:

    a. annual gross revenue of RM10 million;
    b. gross asset of RM5 million at end of the financial year;
    c. an average of 50 employees for the financial year

The qualifying criteria for an exempt entity are based on information needs of users and cost-benefit considerations. If there are external users who rely on the entity's financial statements to make decision and evaluate resource allocation, such an entity is not exempted from preparing financial statements based on the set of accounting standards. It has been a general view that SMEs do not have public accountability and normally prepare accounts for tax purposes, filing with registrar of company, or purely wanting to maintain financial discipline.

Concerns over Compliance Costs of Audit

The burden of audit is the direct cost of performing the audit as well as the management time and resources put into audit. Concerns over costs of audit have been mentioned in anecdotal discussions among owner manager companies who argue the virtues of incurring such costs when the information value does not extend beyond those owners.

Reasons for this survey

This survey is conducted due to the need to have an empirical evidence on the value and costs of audit for small and medium sized companies and focuses primarily on the mandate and objectives laid out in the engagement letter. The methodology and reports of findings that follow are the result of the process of survey conducted to meet those objectives.

Methodology

The study employs mail questionnaire sent to directors of unlisted, private limited companies across all industries operating in the Klang Valley. It is intended to capture the views of directors of companies that are likely to qualify as SMEs from a database maintained by SSM as at 31 December 2004.

A copy of the questionnaire is reproduced in Appendix I.

Research Questions

The aim of the research is to gather data, investigate and analyse the opinions of directors in connection with the benefits or value of statutory audit and in particular to address the following research questions:

- Whether directors of SMEs find statutory audit to be beneficial
- What these benefits are
- Whether directors of SMEs find statutory audit to be costly
- What these costs are
- Whether directors of SMEs find it necessary to make audit of SMEs mandatory
- Whether directors of SMEs would do audit voluntarily should the government decide not to make it mandatory
- What factors would likely motivate directors to do audit voluntarily or otherwise
- Arising from the above findings, what policy decisions can be derived by the authorities to facilitate business growth for SMEs.

Sample Selection and Data Collection

Sample selection began in early February 2005 commencing with identifying a group of companies from a population of unlisted, private limited companies that file their accounts with the SSM as at 31 December 2004.

Selection was made based on turnover of not more than RM100 million as at the last date of reporting and total assets of not more than RM50 million. The threshold amounts presume that a company having more than either the amount is a very large company and potentially a publicly accountable company that is not subject to this study. Dormant companies are also excluded.

This selection resulted in a selection of 2,300 active, independent, unlisted, private limited companies whose policies are not influenced by group policies.

Data was collected using a questionnaire which sent out in February 2005 to 2,300 directors of companies identified from the population in the SSM database, accompanied by a covering letter and a prepaid return envelope.

To increase the response rate, a second wave of questionnaire was sent in early May 2005.

As of the cut off date of 31 May 2005, a total of 407 responses were received out of the 2,300 questionnaires sent out. This represents a response rate of 18% – a respectable survey return rate by Malaysian standard. The number of responses received should enable the researchers to provide the findings with 95 percent confidence.

Further scrutiny of the responses prompted the removal of 39 companies for being either a subsidiary or an associate of a publicly listed company, leaving total of 368 usable responses for analysis. The breakdown of the respondents is as follows:

Companies with turnover	Number of companies	Usable percent
Less than RM10 million	187	55%
Between RM10 million and RM25 million	113	33%
More than RM25 million	40	12%
Sub-total	368	100%
Subsidiary of a listed company	39	
Total	407	

The profile of companies that responded has given credence to the quality of answers and hence the conclusions of findings for this survey. More than half of the respondents have total revenue of less that RM10 million and are therefore deemed 'small', more than a third are deemed 'medium' and the rest are large.

Data Analysis and Findings

This section presents the analysis of the survey aided by a SPSS statistical software version 10.

Profile of Respondents

Size of Companies

The respondents consist of small sized entities (55%), medium sized entities (33%), and large sized entities (12%).

Size based on turnover

		Frequency	Percent	Valid Percent	Cumulative Percent
Valid	small	187	50.8	55.0	55.0
	medium	113	30.7	33.2	88.2
	large	40	10.9	11.8	100.0
	total	340	92.4	100.0	
Missing	System	28	7.6		
Total		368	100.0		

They represent fairly evenly a cross-section of economic sectors like trading (31%), services (24%), manufacturing (18%), construction (16%), investment holdings (5%) and others (6%).

Industry sector

		Frequency	Percent	Valid Percent	Cumulative Percent
Valid	Manufacturing	66	17.9	18.2	18.2
	Construction	57	15.5	15.7	33.9
	Professional Services	86	23.4	23.7	57.6
	Trading	112	30.4	30.9	88.4
	Others	42	11.4	11.6	100.0
	Total	363	98.6	100.0	
Missing	System	5	1.4		
Total		368	100.0		

The presence of a large number of SMEs across a good spread of industry sectors has met favourably the intent of this survey, that is, to find out views from directors of unlisted, private limited companies but principally SMEs that represent a cross-section of the economic activities in Malaysia.

Ownership Structure

More than half of the companies are family owned (67%) while the rest are owned by parties external to family members (33%).

Ownership structure of company

		Frequency	Percent	Valid Percent	Cumulative Percent
Valid	100 percent owned by my family members and I	153	41.6	42.7	42.7
	Majority-owned by my family members and I	87	23.6	24.3	67.0
	Majority-owned by external parties	77	20.9	21.5	88.5
	100 percent owned by external parties	41	11.1	11.5	100.0
	Total	358	97.3	100.0	
Missing	System	10	2.7		
Total		368	100.0		

Qualification

A majority of respondents are key management staff of SMEs who have tertiary or professional education. More than 90 percent of respondents either are directors or chief executives/managing directors of SMEs, of whom 80 percent have tertiary or professional qualification. The seniority and professionalism reflects the quality of information gathered in this survey and provides added credibility to the findings.

Position in Company

		Frequency	Percent	Valid Percent	Cumulative Percent
Valid	Company director	210	57.1	57.9	57.9
	MD/CEO	108	29.3	29.8	87.6
	Finance manager	14	3.8	3.9	91.5
	Accountant	4	1.1	1.1	92.6
	Executive	14	3.8	3.9	96.4
	Others	13	3.5	3.6	100.0
	Total	363	98.6	100.0	
Missing	System	5	1.4		
Total		368	100.0		

Directors' Views on Statutory Audit

The intent of this study is to gather views from directors of unlisted, private limited companies including SMEs about the value of statutory audit to their companies. The fact that 92 percent of the respondents are directors, CEOs and MDs of companies indicates that they would have complete understanding of the costs and benefits of conducting audit for their companies in order to answer the questions credibly.

The value of audit to private companies is presumed to derive from the extent to which the directors perceive audits to be beneficial to and necessary for the company, and whether or not they perceive the audit to be a worthwhile exercise.

How beneficial is audit?

Directors' perceived value on audit is based on the degree of benefits, necessity and worthiness to the company. The table below shows an overwhelming majority of directors (82%) think that financial audit is beneficial. Only 18% think it is not.

How beneficial statutory audit is to your company

		Frequency	Percent	Valid Percent	Cumulative Percent
Valid	Not beneficial at all	18	4.9	5.0	5.0
	Not beneficial	48	13.0	13.2	18.2
	Somewhat beneficial	94	25.5	25.9	44.1
	Beneficial	139	37.8	38.3	82.4
	Very beneficial	64	17.4	17.6	100.0
	Total	363	98.6	100.0	
Missing	System	5	1.4		
Total		368	100.0		

How necessary is it to make audit mandatory?

Likewise, a majority of directors think that audit is necessary for companies and necessary for the audit to be made mandatory (77%). The other 23% think audit is not necessary and it is not necessary to make audit mandatory.

How necessary to make audit mandatory

		Frequency	Percent	Valid Percent	Cumulative Percent
Valid	Not necessary at all	22	6.0	6.0	6.0
	Unnecessary	63	17.1	17.3	23.4
	Somewhat necessary	82	22.3	22.5	45.9
	Necessary	132	35.9	36.3	82.1
	Very necessary	65	17.7	17.9	100.0
	Total	364	98.9	100.0	
Missing	System	4	1.1		
Total		368	100.0		

How worthwhile is audit?

When asked about how worthwhile audit is to their company, a significant number of directors (45%) think that the audit is a worthwhile exercise, 23% think it is not, while 32% is impartial about the worthiness of doing audit for their companies.

Worth to do audit

		Frequency	Percent	Valid Percent	Cumulative Percent
Valid	Strongly disagree	36	9.8	10.1	10.1
	Disagree	48	13.0	13.4	23.5
	Neutral	113	30.7	31.6	55.0
	Agree	108	29.3	30.2	85.2
	Strongly agree	53	14.4	14.8	100.0
	Total	358	97.3	100.0	
Missing	System	10	2.7		
Total		368	100.0		

Views of directors of different sizes of companies on benefits of audit

A closer scrutiny among the small, medium and large sized companies revealed similar opinion among directors of each of the category of companies. They similarly believe the audit is beneficial to their companies as the tables below show for small, medium and large companies.

SMALL (how beneficial is audit)	**No. of responses**	**%**
Not beneficial at all	13	7
Not beneficial	25	13
Somewhat beneficial	47	25
Beneficial	73	39
Very beneficial	28	15
Total	**186**	**100**

Amongst directors of small sized companies, 80 percent believe that there are benefits to conducting audit for their companies; 20 percent think otherwise.

MEDIUM (how beneficial is audit)	**No. of responses**	**%**
Not beneficial at all	4	3
Not beneficial	15	14
Somewhat beneficial	32	29
Beneficial	40	36
Very beneficial	20	18
Total	**111**	**100**

Amongst directors of medium sized companies, 83 percent believe that there are benefits to conducting audit for their companies; 17 percent think otherwise.

LARGE (how beneficial is audit)	**No. of responses**	**%**
Not beneficial at all	0	0
Not beneficial	2	5
Somewhat beneficial	12	29
Beneficial	17	40
Very beneficial	11	26
Total	**42**	**100**

Amongst directors of large sized companies, 95 percent believe that there are benefits to conducting audit for their companies; 5 percent think otherwise.

Views of directors of different sizes of companies on the necessity of audit and making audit mandatory

A closer scrutiny among the small, medium and large sized companies revealed similar opinion among directors of each of the category of companies. They similarly believe the audit is necessary for their companies and also necessary to make it mandatory as the tables below show for small, medium and large companies.

SMALL (how necessary is audit)	**No. of responses**	**%**
Not necessary at all	16	9
Not necessary	31	17
Somewhat necessary	43	23
Necessary	65	35
Very necessary	31	17
Total	**186**	**100**

Amongst directors of small sized companies, 74 percent believe that there are necessary to audit their companies; 26 percent think otherwise.

MEDIUM (how necessary is audit)	**No. of responses**	**%**
Not necessary at all	4	3
Not necessary	20	18
Somewhat necessary	25	23
Necessary	42	38
Very necessary	20	18
Total	**111**	**100**

Amongst directors of medium sized companies, 79 percent believe that there are necessary to audit their companies; 21 percent think otherwise.

LARGE (how necessary is audit)	**No. of responses**	**%**
Not necessary at all	0	0
Not necessary	4	10
Somewhat necessary	10	24
Necessary	17	40
Very necessary	11	26
Total	**42**	**100**

Amongst directors of large sized companies, 90 percent believe that there are necessary to audit their companies; 10 percent think otherwise.

Views of directors of different sizes of companies on the worthiness of conducting audit

The responses of directors on whether audit is a worthwhile exercise are tabulated below according to the size of companies they represent:

Generally, directors of companies believe that audit is a worthwhile exercise.

For example, 45% of directors of small sized companies think that audit is worthwhile for their companies; 31% is impartial, and 25% think it is not.

Worth to do audit

		Frequency	Percent	Valid Percent	Cumulative Percent
Valid	Strongly disagree	23	12.3	12.6	12.6
	Disagree	22	11.8	12.0	24.6
	Neutral	56	29.9	30.6	55.2
	Agree	55	29.4	30.1	85.2
	Strongly agree	27	14.4	14.8	100.0
	Total	183	97.9	100.0	
Missing	System	4	2.1		
Total		187	100.0		

For directors of medium sized companies, 43% think that it is worthwhile, 34% is impartial, and 24% think it is not worthwhile.

Worth to do audit

		Frequency	Percent	Valid Percent	Cumulative Percent
Valid	Strongly disagree	8	7.1	7.1	7.1
	Disagree	19	16.8	16.8	23.9
	Neutral	38	33.6	33.6	57.5
	Agree	29	25.7	25.7	83.2
	Strongly agree	19	16.8	16.8	100.0
	Total	113	100.0	100.0	

For directors of large sized companies, 52% think that it is worthwhile, 29% is impartial, and 19% think it is not worthwhile.

Worth to do audit

		Frequency	Percent	Valid Percent	Cumulative Percent
Valid	Strongly disagree	2	5.0	5.3	5.3
	Disagree	5	12.5	13.2	18.4
	Neutral	11	27.5	28.9	47.4
	Agree	17	42.5	44.7	92.1
	Strongly agree	3	7.5	7.9	100.0
	Total	38	95.0	100.0	
Missing	System	2	5.0		
Total		40	100.0		

The above findings show that directors of private companies including those of SMEs have found the audit to be beneficial, necessary and a worthwhile exercise.

In what ways audit has benefited the company?

The directors were asked to rank the benefits they think have been derived from audit conducted in previous years, and presumably for future years.

The finding shows that the directors believe they have benefited from the audit in the following aspects (in the order of priority of the main four):

- by providing assurance to banks and financial institutions (mean: 3.78 / 5.00)
- through improved record keeping (mean: 3.64 / 5.00)
- in providing assurance to suppliers (mean: 3.50 / 5.00)
- through improved internal control (mean: 3.47 / 5.00)

Costs

Costs of audit are seen to be one of major concerns by directors of private limited companies. This perception is gathered from anecdotal discussions in various forums that often translate into the notion that costs of audit to SMEs often outweigh the benefits of audit. However, as the following set of findings indicates, there is insufficient support to conclude that cost is a major concern to SMEs.

From the analysis, there has been no conclusive evidence to suggest an overwhelming concern for costs. For example, 48% of directors indicated that cost of audit is high relative to the size of their companies. 37% of them is impartial, while the remaining 15% indicated it was not high relative to the size of their companies.

Cost of audit is high relative to size of company

		Frequency	Percent	Valid Percent	Cumulative Percent
Valid	Strongly disagree	21	5.7	5.8	5.8
	Disagree	32	8.7	8.9	14.7
	Neutral	134	36.4	37.1	51.8
	Agree	97	26.4	26.9	78.7
	Strongly agree	77	20.9	21.3	100.0
	Total	361	98.1	100.0	
Missing	System	7	1.9		
Total		368	100.0		

To complement the above finding, directors were asked if time or staff resources required for audit is high relative to the size of their companies. The following finding indicates that only 36% think that it is high, 44% are impartial while the remaining 20% think that it is not high. This seems to suggest that time cost on staff to prepare for audit is not their primary concern.

Time/resource to audit is high

		Frequency	Percent	Valid Percent	Cumulative Percent
Valid	Strongly disagree	16	4.3	4.5	4.5
	Disagree	56	15.2	15.8	20.3
	Neutral	155	42.1	43.7	63.9
	Agree	87	23.6	24.5	88.5
	Strongly agree	41	11.1	11.5	100.0
	Total	355	96.5	100.0	
Missing	System	13	3.5		
Total		368	100.0		

Benefit versus Cost

The above analyses of the elements of costs, when taken together and matched against measure of perceived benefits, unveil suggestion that while directors have reasons to believe that costs are a factor, it is not a primary factor that would inhibit them from conducting the financial audit. The perceived value derived from audit seems more overriding than the cost.

This conclusion is further examined to challenge its robustness by conducting the following tests to determine the propensity of directors of small, medium companies to conduct audit when they are asked whether they would carry out financial audit voluntarily if there were no legal compulsion for them to do so.

Voluntary Audit

If the perceived value of audit is higher than the cost, does this mean that the directors would do audit voluntarily?

If the value of audit is perceived to be higher than the cost, it is logical to expect directors to do the audit voluntarily. A question was asked to test this hypothesis where the directors were requested to indicate whether they would carry out the financial audit voluntarily if they were not required under the law to do so.

Interestingly 71% of them indicated they would carry out the audit anyway, and voluntarily, even if it is not mandated upon them to do so. The other 29% indicated they would not.

If not required by law, would do audit voluntarily

		Frequency	Percent	Valid Percent	Cumulative Percent
Valid	Yes	255	69.3	71.0	71.0
	No	104	28.3	29.0	100.0
	Total	359	97.6	100.0	
Missing	System	9	2.4		
Total		368	100.0		

A breakdown of opinion among directors of small, medium and large companies indicates similar conclusion with an overwhelming majority indicated they would carry out audit even if the law does not require them to do so as the table below indicates.

If not required by law, would do audit voluntarily* size based on turnover Crossstabulation

			size based on turnover			Total
			small	medium	large	
If not required by law, would do audit voluntarily	Yes	Count	122	84	32	238
		% within size based on turnover	66.7%	75.7%	80.0%	71.3%
	No	Count	61	27	8	96
		% within size based on turnover	33.3%	24.3%	20.0%	28.7%
Total		Count	183	111	40	334
		% within size based on turnover	100.0%	100.0%	100.0%	100.0%

The findings show that out of 183 directors of small sized companies who answered this question, 122 (66%) indicated they would carry out audit voluntarily. Out of 111 directors of medium sized companies who answered this question, 84 (76%) indicated they would carry out audit voluntarily and out of 40 directors of large sized companies who answered this question, 32 (80%) indicated they would carry out audit voluntarily.

Why would directors do audit voluntarily?

The motivations behind the directors' willingness to carry out voluntary audit of their companies seem to have pointed towards the following factors relating to:

- Corporate governance, transparency and accountability (39%)
- Internal control (34%)
- Financing and tax filing (20%), and
- Other reasons (7%).

Conclusions

This study is conducted to meet the Corporate Law Reform Committee's desire to determine empirically the views of directors on cost and benefit of statutory audit by unlisted, private limited companies in Malaysia, particularly by the small and medium sized companies. This desire is to support the overall objective of the Committee's on-going review of the Companies Act to promote business growth and create a sustainable business environment for companies.

The mail survey conducted successfully captured the required number of respondents across industries and across different sizes of companies to be able to deduce results with ninety five percent confidence level.

The findings empirically show that directors of small and medium companies are of the view that there are benefits to doing financial audit for their companies so much so that they are prepared to do the audit voluntarily even if the Act does not mandate them to do so. A large majority has the view that audit is beneficial, necessary and a worthwhile exercise and expect audit to enhance transparency, corporate governance and internal control, surpassing the benefit of using the audit for purposes of taxes and bank financing.

Costs of doing audit, which has hitherto been thought to be the main impediment to small and medium businesses, seem to be a factor that can be managed by companies.

The findings of this study pose interesting implications for the Committee and the Companies Commission of Malaysia. They have a few decision and policy choices to make.

Firstly, the Committee may recommend that SSM maintains its present policy of mandating all companies, other than exempt private companies, to file audited accounts annually to SSM. The findings of the study support empirically the notion that SMEs have found benefits to financial audit and are prepared to carry out the audit voluntarily. This shows their level of propensity to continue audit of their accounts. They have been filing audited accounts hitherto and presumably would not hesitate to continue filing the audited accounts in the future if the Act continues to require submission of the audited accounts.

Secondly, the Committee may recommend exempting SMEs from filing the audited accounts, in the interest of encouraging them to further reduce the costs of doing business and facilitating business by cutting unnecessary red-tape. The SMEs, however, would still be required to audit the accounts but merely file submissions in the form of a statement by directors about the company solvency and others similar to the form and content of submission currently accorded to exempt private companies. The advantage of this policy choice is that it will relieve the SMEs of the burden of filing the audited accounts. The disadvantage of this policy choice is the loss of monitoring of SMEs when they are availed of the requirement to submit financial information to SSM.

Thirdly, the Committee may recommend an outright exemption from auditing the accounts as well as filing the accounts altogether. This option means that SMEs do not have to audit and do not have to file the accounts to SSM. If this option is taken, SMEs will be relieved of the need to audit their accounts and at the same time SSM will no longer have control over any record of the financial positions of SMEs.

Members of Working Group A, after having deliberated the matter, are in favour of maintaining the status quo and herewith submit their recommendation to the Steering Committee of the Corporate Law Reform Committee.

END

Appendix1

Questionnaire

Survey of Company Director's Views on Statutory Audit

Commissioned by

Corporate Law Reform Committee

of the

Companies Commission of Malaysia

February 2005

The objective of this survey is to solicit the views of directors of small and medium enterprises (SMEs) regarding the value of statutory audit to their company and to examine their views on voluntary audit.

This questionnaire requires 15 minutes of your time. Please answer each question as openly and honestly as possible. Neither your name, nor that of your company will be identified in the final report.

Please use the reply-paid envelope provided to submit your response by
Thursday, 31 March 2005.

Thank you.

Section A

1. How do you describe the ownership structure of your company?

(Tick one box only)

- ❑ 100 percent owned by my family members and I
- ❑ majority-owned by my family members and I
- ❑ majority-owned by external parties
- ❑ 100 percent owned by external parties

2. Is your company a subsidiary or an associate of a publicly listed company?

- ❑ Yes (proceed to question 24)
- ❑ No

3. Does your company employ an external accountant or company secretary to prepare accounts for filing at Companies Commission of Malaysia?

- ❑ Yes
- ❑ No (proceed to question 5)

4. Which of the following services does the external accountant or company secretary provide? (Tick as many boxes as applicable)

- ❑ Accounting services
- ❑ Audit
- ❑ Tax
- ❑ Management consultancy
- ❑ IT services
- ❑ Investment and finance advice
- ❑ Company secretarial services
- ❑ Others, please specify: ______________________

5. What was the audit fee you paid for the most recent annual accounts?

Audit fees total: RM ______________________

Section B

6. Generally, how beneficial do you think statutory audit is for companies like yours?

- ❑ Very beneficial
- ❑ Beneficial
- ❑ Somewhat beneficial
- ❑ Not beneficial
- ❑ Not beneficial at all

7. Generally, how necessary is it to make the audit mandatory for companies like yours?

- ❑ Very necessary
- ❑ Necessary
- ❑ Somewhat necessary
- ❑ Unnecessary
- ❑ Not necessary at all

8. If you are NOT required by law to have your accounts audited, would you still voluntarily have your accounts audited anyway?

- ❑ Yes, why?______________________________
- ❑ No, why not?______________________________

9. If your accounts are NOT audited, would it affect your ability to raise capital?

❑ Yes ❑ No

10. To what extent do you rely on audited accounts of your suppliers or customers when carrying out credit check on them?

- ❑ Very much
- ❑ Much
- ❑ Somewhat
- ❑ Not much
- ❑ Not at all

11. Please indicate the extent to which you agree or disagree with the following statements regarding the statutory audit in your company.

	strongly disagree 1	2	3	4	strongly agree 5
• The cost of audit is high relative to the size of my company	O	O	O	O	O
• The value derived from audit is more than the fees paid to get the audit done	O	O	O	O	O
• The time and resources required to audit is high	O	O	O	O	O
• The audit exercise on my company is worth it	O	O	O	O	O

12. Please indicate the extent to which you agree or disagree with the following statements regarding the <u>accounting standards</u>.

	strongly disagree 1	2	3	4	strongly agree 5
• The cost of compliance with accounting standards are high for a company like mine	O	O	O	O	O
• Complying with accounting standards brings many benefits for a company like mine	O	O	O	O	O
• Accounting standards of international quality is appropriate for my company	O	O	O	O	O
• There is no need for an accounting standard for a company like mine	O	O	O	O	O

13. Please indicate the extent to which you agree or disagree with the following statements regarding the benefits of statutory audit to your company.

The audit conducted for my company in the previous years:

	strongly disagree 1	2	3	4	strongly agree 5
• has increased the credibility of financial information	O	O	O	O	O
• has improved the image of my company	O	O	O	O	O
• has improved the perception of people on my company	O	O	O	O	O

• has helped to deter misappropriation of funds or fraud	O	O	O	O	O
• has improved system of record keeping and accounting	O	O	O	O	O
• has provided assurance to shareholders	O	O	O	O	O
• has provided assurance to banks and lenders	O	O	O	O	O
• has provided assurance to suppliers and creditors	O	O	O	O	O
• has improved internal controls within the company	O	O	O	O	O
• has improved the company's ability to raise finances	O	O	O	O	O
• has increased my confidence in the reported figures in the financial statements to make company decisions	O	O	O	O	O

14. Apart from Companies Commission, which of the following users have requested for or were sent a copy of the company's statutory accounts?

(Tick as many boxes as apply)

- ❑ Shareholders
- ❑ Investors
- ❑ Bank and other providers of finance
- ❑ Independent directors
- ❑ Major suppliers and trade creditors
- ❑ Major customers
- ❑ Inland Revenue Board
- ❑ Others, please specify:________________________________

15. In the next few years, which of the following users would likely depend on your audited accounts to make their decisions?

(Tick as many boxes as apply)

- ❑ Shareholders
- ❑ Investors
- ❑ Bank or other providers of finance
- ❑ Independent directors
- ❑ Major suppliers or trade creditors
- ❑ Major customers
- ❑ Inland Revenue Board
- ❑ Others, please specify:________________________________

16. **Apart from capital invested by the shareholders, is the company currently financed by any of the following?** (Tick as many boxes as apply)

- ❑ Bank finance
- ❑ Venture capital
- ❑ Leasing
- ❑ Hire purchase
- ❑ Factoring
- ❑ Personal loans from family or friends
- ❑ Others, please specify: ____________________

Section C

Finally, please fill in the questions below that best describe your company.

17. **Industry type**

- ❑ Manufacturing
- ❑ Construction/property development
- ❑ Professional services
- ❑ Public trustee
- ❑ Trading
- ❑ Others, please specify: ____________________

18. **Total turnover for financial year 2003/2004: RM** ____________________

19. **Total assets for financial year 2003/2004: RM** ____________________

20. **Total number of full time employees:**

21. **Are you planning to list the company on Bursa Malaysia in the next 3-5 years?**

❑ Yes ❑ No

22. **What is your position in the company? (Tick one box only)**

- ❑ Company director
- ❑ Managing Director or CEO
- ❑ Finance manager
- ❑ Accountant
- ❑ Executive
- ❑ Others (please specify): ____________________

23. Do you have any of the following qualifications / training?
(Tick as many boxes as apply)

- ❑ Post-graduate degree
- ❑ Undergraduate degree
- ❑ Professional qualification
- ❑ Vocational qualification
- ❑ Certificate in business
- ❑ Others, please specify: ______________________________

24. Why do you think people choose to incorporate companies as a Sendirian Berhad or Berhad as opposed to registering the business as a partnership or a sole proprietorship? (Tick as many boxes as apply)

- ❑ Prospect for growth
- ❑ Reputation
- ❑ Credibility
- ❑ Limited liability
- ❑ Easy access to funding
- ❑ Tax advantage
- ❑ Continuity of business
- ❑ Others (please specify): ______________________________

25. Why do you think people choose to register a business as a partnership or a sole proprietorship as opposed to incorporating the business as a Sendirian Berhad or Berhad? (Tick as many boxes as apply)

- ❑ Easy to manage
- ❑ Less statutory red-tape to establish
- ❑ No intent to grow beyond the few partners
- ❑ Less stringent statutory requirement to comply once established
- ❑ No need to lodge accounts with ROB
- ❑ Cost of doing business is cheaper
- ❑ Others (please specify): ______________________________

Thank you for your time.

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