NEW "SMALL COMPANY" CONCEPT FOR AUDIT EXEMPTION

Practical Application (Part 1)

By
KANG WAI GEAT, ZOEY XIE AND LAW REFORM DEPARTMENT, ACRA

In ***IS Chartered Accountant***, March 2015, the key changes in the Companies (Amendment) Act 2014, including the introduction of new criteria for qualification as a "small company" for audit exemption, were discussed in the article titled "Recent Legislative Changes to the Companies Act". To recap, in order to qualify as a "small company", a company must be a private company that fulfils at least two of the following three quantitative criteria in each of the immediate past two financial years (FYs):

(a) Total annual revenue of not more than $10 million;
(b) Total assets of not more than $10 million;
(c) Number of employees of not more than 50.

PHOTO **SHUTTERSTOCK**

This replaces the current audit exemption for exempt private companies with annual revenue of $5 million or less for the FY.

The "small company" criteria recognise a broader group of stakeholders (for example, creditors, employees, customers, etc) who may have an interest in the financial statements, other than just shareholders. Similar criteria are used for differentiated financial reporting in other countries such as the United Kingdom and Australia. While audits can be useful, they cost time and money. The new audit exemption is intended to help reduce regulatory costs for smaller companies that do not have wide market impact, and would result in a reduction in compliance costs for at least 25,000 small companies which currently do not qualify for audit exemption. Existing safeguards will however be retained, such as requiring all companies to keep proper accounting records, and empowering shareholders with at least 5% voting rights to require a company to prepare audited accounts.

In this article, we illustrate the application of the new "small company" concept in three scenarios, assuming these companies are not part of a group of companies:

1) Transitional provisions for the first two FYs after the commencement of the "small company" criteria;
2) General applicability;
3) New companies incorporated after the commencement of the "small company" criteria.

1) TRANSITIONAL PROVISIONS

The transitional provisions are applicable to companies that are incorporated before the date of the commencement of the new "small company" criteria.

Such a company can qualify as a "small company" if it is a private company and meets the quantitative criteria in the first or second FY *commencing on or after the date of commencement of the "small company" criteria.*

PHOTO SHUTTERSTOCK

★

The new audit exemption is intended to help reduce regulatory costs for smaller companies that do not have wide market impact, and would result in a reduction in compliance costs for at least 25,000 small companies which currently do not qualify for audit exemption.

A company which has qualified as a "small company" in the first or second FY commencing on or after the date of commencement of the "small company" criteria continues to be a "small company" until it is disqualified as a "small company". Disqualification would occur if it:

a) Ceases to be a private company at any time during the FY, or

b) Does not meet the quantitative criteria for the immediate past two consecutive FYs.

Figure 1 illustrates the transitional provisions.

Figure 1 Two scenarios to illustrate transitional provisions

Scenario 1a	FY 2015	FY 2016	FY 2017	FY 2018	FY 2019	FY 2020
Meets quantitative criteria	√	X	√	X	X	√
Qualifies as a "small company"	√	√	√	√	√	X
Remarks	FY 2015 is the first FY after the commencement of the "small company" criteria. The company qualifies as a "small company" as it is a private company and meets the quantitative criteria in FY 2015.	As the company already qualified as a "small company" in FY 2015, it continues to be a "small company" despite not meeting the quantitative criteria in FY 2016. It will only be disqualified when it fails to meet the quantitative criteria for two consecutive FYs preceding FY 2016.	The company already qualified as a "small company" in FY 2015 and is not disqualified. It is not disqualified as it has only failed to meet the quantitative criteria for one of the two preceding FYs (that is, FY 2016).	As the company already qualified as a "small company" in FY 2015, it continues to be a "small company" despite not meeting the quantitative criteria in the current FY and for one of the two preceding FYs.		Although the company meets the quantitative criteria in the current FY, it is disqualified because it fails to meet the quantitative criteria for two consecutive FYs preceding the current FY (that is, FY 2018 and FY 2019).
Scenario 1b	**FY 2015**	**FY 2016**	**FY 2017**	**FY 2018**	**FY 2019**	**FY 2020**
Meets quantitative criteria	X	√	√	X	X	√
Qualifies as a "small company"	X	√	√	√	√	X
Remarks	FY 2015 is the first FY after the commencement of the "small company" criteria. The company does not qualify as a "small company" as it does not meet the quantitative criteria in FY 2015.	FY 2016 is the second FY after the commencement of the "small company" criteria. The company qualifies as a "small company" as it is a private company and meets the quantitative criteria in FY 2016 (that is, FY 2015 is not taken into consideration).	The company continues to be a "small company" as it qualified as a "small company" in FY 2016 and is not disqualified. It is not disqualified as it has only failed to meet the quantitative criteria for one of the two preceding FYs.	As the company already qualified as a "small company" in FY 2016, it continues to be a "small company" despite not meeting the quantitative criteria in the current FY. It will only be disqualified when it fails to meet the quantitative criteria for two consecutive FYs preceding the current FY.	As the company already qualified as a "small company" in FY 2016, it continues to be a "small company" despite not meeting the quantitative criteria in the current FY and for one of the two preceding FYs.	Although the company meets the quantitative criteria in the current FY, the company is disqualified because it fails to meet the quantitative criteria for two consecutive FYs preceding the current FY (that is, FY 2018 and FY 2019).

Figure 2 Three scenarios to explain the applicability of the new "small company" criteria

Scenario 2a

(i) Company *meets* the quantitative criteria in FY 2015 and FY 2016;
(ii) Company is a "small company" in FY 2016.

	FY 2017	FY 2018	FY 2019	FY2020	FY2021	FY 2022
Meets quantitative criteria	✓	X	✓	X	X	✓
Qualifies as a "small company"	✓	✓	✓	✓	✓	X
Remarks	The company already qualified as a "small company" and is not disqualified.	As the company already qualified as a "small company", it continues to be a "small company" despite not meeting the quantitative criteria in the current FY. It will only be disqualified when it fails to meet the quantitative criteria for two consecutive FYs preceding the current FY.	The company is not disqualified as it has only failed to meet the quantitative criteria for one of the two preceding FYs (that is, FY 2018).	Although the company does not meet the quantitative criteria in the current FY, it continues to be a "small company" as it is not disqualified. It is not disqualified as it has only failed to meet the quantitative criteria for one of the two preceding FYs.		Although the company meets the quantitative criteria in the current FY, it is disqualified because it fails to meet the quantitative criteria for two consecutive FYs preceding the current FY (that is, FY 2020 and FY 2021).

Scenario 2b

(i) Company *does not meet* the quantitative criteria in FY 2015 and FY 2016;
(ii) Company is *not* a "small company" in FY 2016.

	FY 2017	FY 2018	FY 2019	FY2020	FY2021	FY 2022
Meets quantitative criteria	✓	✓	✓	X	X	✓
Qualifies as a "small company"	X	X	✓	✓	✓	X
Remarks	As the company does not meet the quantitative criteria in the two consecutive preceding FYs (that is, FY 2015 and FY 2016), it does not qualify as a "small company" in FY 2017 even though it meets the quantitative criteria in the current FY.	As the company only meets the quantitative criteria in one of the two preceding FYs, it does not qualify as a "small company" in FY 2018.	The company qualifies as a "small company" as it meets the quantitative criteria in the two consecutive FYs preceding the current FY (that is, FY 2017 and FY 2018).	As the company already qualified as a "small company", it continues to be a "small company" despite not meeting quantitative criteria in the current FY. It will only be disqualified when it fails to meet the quantitative criteria for two consecutive FYs preceding the current FY.		Although the company meets the quantitative criteria in the current FY, it is disqualified because it fails to meet the quantitative criteria for two consecutive FYs preceding the current FY (that is, FY 2020 and FY 2021).

Scenario 2c

(i) Company *meets* the quantitative criteria in FY 2015 and FY 2016;
(ii) Company is a "small company" in FY 2016

	FY 2017	FY 2018	FY 2019	FY2020	FY2021	FY 2022
Meets quantitative criteria	X	X	✓	✓	✓	✓
Qualifies as a "small company"	✓	✓	X	X	✓	✓
Remarks	As the company already qualified as a "small company", it continues to be "small company" despite not meeting the quantitative criteria in the current FY. It will only be disqualified when it fails to meet the quantitative criteria for two consecutive FYs preceding the current FY.		The company is disqualified because it fails to meet the quantitative criteria for two consecutive FYs preceding the current FY (that is, FY 2017 and FY 2018).	As the company does not meet the quantitative criteria in the immediate past two consecutive FYs (that is, FY 2018 and FY 2019), it does not qualify as a "small company" in FY 2020.	The company qualifies as a "small company" as it meets the quantitative criteria in the immediate past two consecutive FYs (that is, FY 2019 and FY 2020).	The company continues to be a "small company" as it qualified as a "small company" in FY 2021 and is not disqualified.

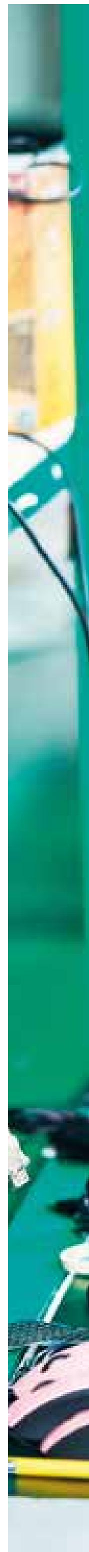

PHOTO SHUTTERSTOCK

2) GENERAL APPLICABILITY

A company qualifies as a "small company" in a particular FY if the company is a private company and meets the quantitative criteria in the previous two consecutive FYs.

The illustrations in Figure 2 are designed to explain the applicability of the new "small company" criteria in general circumstances, and are provided based on the assumption that the company is a private company throughout the periods covered in the illustrations.

3) COMPANIES INCORPORATED AFTER COMMENCEMENT DATE OF "SMALL COMPANY" CRITERIA

For companies incorporated after commencement date of the "small company" criteria, the assessment for qualification as a "small company" mirrors the aforementioned transitional provisions. A company would qualify as a "small company" in its first or second FY *after incorporation* if the company is a private company and meets the quantitative criteria in the FY for which the financial statements are being prepared.

SUMMARY

Readers can see from the various scenarios in the illustrations that different principles of assessment for qualification as a "small company" would apply during the transitional period immediately after the commencement of the "small company" criteria and for the first two FYs of a new company, as compared to the general applicability of the criteria. In addition, the key point to note is that disqualification as a "small company" only occurs when a company fails to meet the quantitative criteria for two consecutive preceding FYs.

In the next issue of the ***IS Chartered Accountant***, we will delve into the applicability of the "small company" criteria on a consolidated group basis. ISCA

This article was jointly developed by Kang Wai Geat, Assistant Director, and Zoey Xie, Manager, Technical Standards Development and Advisory Department, ISCA, and the Law Reform Department, Accounting and Corporate Regulatory Authority.