Developing a Small Business Regulatory System

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Introduction

Thank you for inviting me to share my thoughts on what the government is doing to reduce the burden on small business. I also look forward to hearing the other speakers talk about how to make the regulatory system more responsive and relevant to business needs.

It is more than a year since the fall of Lehman Brothers and the beginning of the Australian Government's response to the global financial crisis.

Today, the Australian economy is showing encouraging signs of recovery. The Government's policy responses have been largely responsible for placing Australia in a better position than most countries around the world.

The *Mid-Year Economic and Fiscal Outlook* (MYEFO) (released earlier this month) showed that the economy is performing much better than was forecast in the last Budget — MYEFO shows that Australia is the only advanced economy to have recorded positive growth through the year to June 2009. MYEFO also upgraded the growth forecasts for the following two years with consequental falls in the expected peak unemployment rate.

Although this is good news, the GFC has clearly affected, and is continuing to impact on, small business.

A number of Australian Chamber of Commerce and Industry surveys have reported large falls in small business confidence and conditions throughout 2008 and early 2009. However, the August *ACCI Small Business Survey* reports that, while conditions for small business are expected to remain challenging, conditions are stabilising.

This good news is supported by the most recent *Commonwealth Bank – ACCI Business Expectations Survey*, which shows that small, medium and large businesses are expecting business conditions to improve significantly during this quarter.

It is true that small businesses succeed or fail on the creativity, ingenuity, innovation and imagination of their owners and staff. It is also true that small businesses are notoriously time poor. When considering ways to improve the regulatory framework for small businesses it is important to weigh up the desire to minimise time spent by businesses on compliance, with maintaining the integrity of the market as a whole.

People in my position rely on people like you with the specific knowledge and expertise in small business matters to make sure that reforms are developed which benefit both the small business sector and the wider economy.

Small Business Regulatory System

In May 2007, Treasury jointly hosted a symposium on corporate governance for small corporations with the National Institute for Governance at the University of Canberra. This symposium highlighted the complexity of governance arrangements for small businesses using a corporate structure, and raised a number of issues on the benefits of regulatory oversight.

The general view expressed at the symposium was that the current corporate governance regulatory system is too heavily geared to large companies. This is not a new criticism and given that the regulatory framework and governance norms for Australian companies are based on the assumption that there is a separation between the ownership and management of the company, it is not an unfounded criticism.

It is not surprising that the system was developed with the larger corporates in mind as the framework does reflect the reality that larger companies are directly responsible for a high proportion of output and employment.

From the symposium, we learned that in the interests of better targeted regulation and reducing red tape, it was important to improve understanding of how corporate governance requirements can be better tailored to meet the needs of small businesses using a corporate structure.

That is why Treasury is pleased to collaborate with Victoria University and the Council of Small Business of Australia on this project.

The driving factor underpinning any reform should be an economic one. Our focus during this project will be on making sure that corporate governance regulation improves the performance of all corporations, including small corporations, through improved efficiency, quality, accountability and integrity.

We anticipate that his project will examine the adequacy of the current corporate governance framework for small corporations and increase the knowledge base around three important questions.

Firstly, to what extent can the default governance rules, that is, the replaceable rules in the Corporations Act, be tailored to small corporations?

The success of the replaceable rules in the Corporations Act is based on how closely the rules reflect the terms that the parties themselves would most commonly choose. The replaceable rules are intended to save time and money for companies with more straightforward business affairs.

Both government and industry are seeking to close any gaps between the current governance arrangements and the current replaceable rules. It is through projects such as this that the knowledge base needed to identify those gaps can be developed.

Secondly, are there any mandatory governance rules, such as the directors' duties or meeting requirements, that should be modified or removed for small corporations?

While there is a clear case for making mandatory rules that serve a protective or disclosure function with sanctions for non compliance, there is a question as to whether some of these rules may be turned off, moderated or recast as default rules for small corporations. The desire to ease the regulatory burden on small business should be weighed against the need for consistency and certainty.

Thirdly, from a practical standpoint, Treasury would like to find out whether there is a call for guidance materials, such as a draft governance code or other educational instruments, to help reduce the burden on small business.

The setting up of benchmarks for best practice in corporate governance of small corporations is an exercise that has been taken up in other jurisdictions, but which has not been appropriately dealt with in Australia.

Problems occur when parties remain ignorant of rules – until a dispute arises. Small businesses incorporate for a variety of reasons and once incorporated, are subject to the same corporate governance requirements as large incorporated entities. Unfortunately, the level of knowledge of the regulatory obligations is difficult to gauge.

As I said earlier, it is through the development of a better knowledge base that we can gain a better understanding of the policies that will help small business to contribute more to the wellbeing of Australia.

Treasury expects that the research and data from this project, especially in respect to these three areas, will play a valuable role in supporting future policy development.

Financial Reporting

Of course, the regulatory system affecting small business extends beyond corporate governance obligations. Successive governments have been mindful that the Corporations Act's financial reporting requirements can be burdensome to business.

The introduction of the small/large criteria for proprietary companies in the late 1990s was a significant move towards reducing the regulatory burden for such companies. The Corporations Act currently defines a small proprietary company as one that satisfies at least two of the following criteria:

- Consolidated revenue for the financial year of less than $25 million
- Consolidated gross assets at the end of the financial year of less than $12.5 million and
- Fewer than 50 employees at the end of the financial year.

Under this definition, around 98 per cent of Australia's 1.6 million proprietary companies are classified as small and, with some exceptions, do not have to prepare annual financial statements and lodge them with ASIC.

The question is what is being done for the remaining 30,000 or so companies that are required to prepare financial statements and lodge them with ASIC? At present, these companies are required to prepare their financial statements in accordance with the full body of international financial reporting standards or IFRS.

A number of these companies are large listed entities and are required to prepare and lodge financial statements in accordance with IFRS. There are, however, some smaller, non-listed companies, which also have to prepare and lodge full financial statements.

Earlier this year the International Accounting Standards Board issued a standard on financial reporting by small and medium-sized entities that are not publicly accountable. This standard … usually referred to as IFRS for SMEs … seeks to reduce the financial reporting burden for smaller entities through the adoption of simplified recognition and measurement criteria, and a significant reduction in the number of items that must be disclosed in the financial statements.

A number of overseas jurisdictions have already decided to adopt this standard as the basis of financial reporting by their smaller entities.

The Australian Accounting Standards Board is currently looking at whether IFRS for SMEs should be used in Australia or whether we should develop our own SME standard based on the recognition and measurement criteria in the full body of IFRS and the disclosure requirements in IFRS for SMEs.

A paper is expected to be released shortly seeking stakeholder views on these options.

Treasury is also considering a number of other measures designed to reduce the burden the Corporations Act financial reporting requirements place on business. These include the possible introduction of differential reporting requirements for companies limited by guarantee – essentially those with a not-for-profit focus and revised reporting requirements for companies that are parent entities.

The Government will consult with business and the wider community prior to adopting any such measures.

Small Business Tax amendments

The Government has also introduced a number of tax measures to help small businesses in the current economic environment.

Reduction in pay-as-you-go instalments

The Government provided immediate and much needed cash flow relief to eligible small businesses by reducing their pay-as-you-go (PAYG) instalment amount by 20 per cent for the quarter that includes 31 December 2008. Broadly, the reduction applies to small businesses that make four quarterly PAYG instalments using the instalment amount calculated by the Commissioner of Taxation and printed on their Business Activity Statement —the GDP-adjusted notional tax method.

To provide further cash flow relief to small businesses the Government also reduced the PAYG instalment amounts for the 2009-10 income year for all taxpayers who pay quarterly instalments using the GDP-adjusted notional tax method.

Small Business and General Business Tax Break

The Government's *Nation Building and Jobs Plan* included a Small Business and General Business Tax Break to support Australian businesses — in particular small businesses — undertaking capital investment.

As part of the 2009-10 Budget, the Government expanded the Small Business and General Business Tax Break. Small businesses can claim a bonus tax deduction of 50 per cent — up from 30 per cent previously – of the cost of eligible assets acquired between 13 December 2008 and 31 December 2009, and installed by 31 December 2010. The tax break is available for most types of machinery and equipment used in business.

Research and development tax incentive

From 1 July 2010, the Government will replace the complex and outdated research and development or R&D tax concession scheme with a new R&D tax incentive that will cut red tape and provide a better incentive for business to invest in research and development. The new R&D tax incentive includes a 45 per cent Refundable R&D Tax Credit, available to companies with a turnover of less than $20 million — this is equivalent to a tax deduction of 150 per cent.

As an interim measure in the lead up to the new scheme, the Government has increased the expenditure cap for eligibility to the existing R&D tax offset from $1 million to $2 million from 1 July 2009. Lifting the expenditure cap provides a further boost to small pre-profit companies in research intensive industries.

ATO assistance to small business

The Government provided around $100 million to support small businesses experiencing difficulties meeting their tax liabilities as a result of the global recession. Early and tailored assistance from the ATO helped viable but struggling businesses stay in business helping to support Australian jobs.

Further, the Commissioner of Taxation announced new measures to support small businesses owing tax. These include a 12-month interest-free debt repayment arrangement for businesses with turnovers of up to $2 million that are struggling to meet their obligations and an interest-free deferral of the payment due date on activity statement liabilities to help small businesses manage short-term cash flow problems.

Standard Business Reporting

I would also like to talk about the Standard Business Reporting initiative currently being driven by the Treasury, which I expect to have profound practical implications for small businesses.

Under this initiative, reporting by businesses — for example, their Business Activity Statements — to the main government agencies — including ASIC, APRA, ATO, state revenue offices and the ABS will be streamlined. Business-to-government reporting will be simplified by:

- Removing unnecessary information from forms
- Adopting a common reporting language
- Providing business with a single secure online sign-on to the agencies involved
- Utilising software to pre-populate government forms
- Providing an electronic interface to report to government as a by-product of business processes.

This initiative directly attacks compliance costs and is expected to save businesses around $800 million each year following full implementation.

By being able to understand the requirements better, business will be able to self-prepare and lodge their reports easily and quickly. In return, businesses will be better able to access to up-to-date financial information, more readily share financial/accounting data and more comprehensive audit trails.

It is expected that financial statements that result from the use of International Financial Reporting Standards and the SBR taxonomies will be compliant and reliable, providing further benefits to businesses that operate internationally.

Pilot projects to implement SBR are being undertaken with further progress expected in 2010.

Conclusion

Our work in Treasury, and the work of Victoria University in researching policies to reform small business regulation, will augment the work being undertaken by the ATO and other agencies to address the concerns of small business. Allowing small businesses to earn a fairer share from the growth in the economy as the world emerges from the GFC is a significant policy challenge, but one where we think there is a high probability of success.