Submission

by

Business | NZ

to the

Ministry of Economic Development

on the

Discussion Document Concerning Financial Reporting for Small Companies

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PO Box 1925
Wellington
Ph: 04 496 6555
Fax: 04 496 6550

1. Introduction

1.1. Encompassing five regional business organisations (Employers' & Manufacturers' Association (Northern), Employers' & Manufacturers' Association (Central), Canterbury Employers' Chamber of Commerce, Canterbury Manufacturers' Association, and the Otago-Southland Employers' Association), Business New Zealand is New Zealand's largest business advocacy body. Together with its 49-member Affiliated Industries Group (AIG), which comprises most of New Zealand's national industry associations, Business New Zealand is able to tap into the views of over 76,000 employers and businesses, ranging from the smallest to the largest and reflecting the make-up of the New Zealand economy.

1.2. In addition to advocacy on behalf of enterprise, Business New Zealand contributes to Governmental and tripartite working parties and international bodies including the ILO, the International Organisation of Employers and the Business and Industry Advisory Council to the OECD.

1.3. Business New Zealand's key goal is the implementation of policies that would see New Zealand retain a first world national income and regain a place in the top ten of the OECD (a high comparative OECD growth ranking is the most robust indicator of a country's ability to deliver quality health, education, superannuation and other social services). It is widely acknowledged that consistent, sustainable growth well in excess of 4% per year would be required to achieve this goal in the medium term.

1.4. One way to achieve the required level of sustainable growth is to ensure businesses have every opportunity to grow. As a large proportion of New Zealand businesses are small-medium sized enterprises (currently 92.5% of New Zealand enterprises have nine or fewer full-time equivalent workers[1]), Government policies that affect businesses should take into account ways to

[1] Business Demography Statistics, Feb 2002, *Statistics New Zealand.*

reduce compliance costs these small enterprises face. The review of the Except Companies Regime is a positive step in that direction.

2. Discussion

2.1. Business New Zealand welcomes the Government's steps towards reviewing the Exempt Companies Regime (ECR), within the framework of the Financial Reporting Act (FRA) 1993. We advocate any lowering of compliance costs for businesses, where unnecessary practices or duplication of material means resources could be used more effectively elsewhere.

2.2. The benefits businesses receive from compiling financial reports are invaluable in terms of understanding their current position, as well as providing guidance for future planning. If businesses wish to expand, a clear, accurate and accessible set of financial reports is crucial in making that decision. Put simply, the act of compiling financial reports is 'good business'.

2.3. Given the important role financial records play, a correct mix of having standards in place to make sure financial records are kept, while an optimal number of records are compiled without any unnecessary duplication is essential.

2.4. As well as non-regulatory incentives for compiling financial information, there are already regulatory incentives in place to insure financial records are maintained by businesses. Obligations such as those under the Companies Act 1993, and tax legislation to maintain records such as the IR10 provide financial information and foster financial discipline. Given the regulatory and non-regulatory incentives already in place for companies that would fall under the ECR framework to prepare and analyse financial reports, Business New Zealand recommends that the ECR be removed so that exempt companies become truly exempt from the requirements of the FRA 1993.

Recommendation: **The Exempt Companies Regime is removed so that companies become truly exempt from the requirements of the Financial Reporting Act 1993.**

2.5. Business New Zealand would also like to see further work done to lower compliance costs, no matter what the size of the business is. In a report issued in 2001 entitled *Finding the Balance: Maximising Compliance at Minimum Cost*, the Ministerial Panel on Business Compliance Costs noted that a number of different legislative measures require reporting and filing using slightly different criteria. They cited that the FRA 1993, the Superannuation Schemes Act 1989, the Life Insurance Act 1908 and the Securities Act 1978 all require separate reporting and filing. Also, surveys administered by Statistics New Zealand such as the Annual Enterprise Survey ask for financial results in considerable detail. We would like to see the Government implement the panel's recommendation that it investigate the idea of businesses preparing only one set of financial reports that comply with relevant reporting standards, and that can then be used for all regulatory purposes.

Recommendation: **Further work is done on whether enterprises should be able to compile one set of financial records that serve all regulatory purposes.**

2.6. In addition to making companies currently under the ECR completely exempt from the FRA, we also recommend a change in the exemption thresholds involving assets and turnover for being classed as an exempt company. While the discussion document on financial reporting mentions that consideration is being given to changing the asset and turnover thresholds, it does not indicate in which direction the changes should be. We would like to point out that if consideration is given to lowering either the asset or turnover threshold, this could undo any attempts to reduce compliance costs for small-medium sized businesses, as the number who would have to meet the full obligations under the FRA would probably increase.

2.7. In our view turnover would be a more accurate measure in terms of a threshold, as asset testing can be subject to manipulation by companies. Assets can be placed in a trust and leased back to the company, meaning a company can control the asset value, while a turnover value cannot be so easily manipulated. Therefore, Business New Zealand would like to see assets withdrawn as a criterion for evaluating whether a company is deemed to be an exempt company.

Recommendation: **Assets as a criterion for evaluating whether a company is deemed to be an exempt company is removed.**

2.8. Notwithstanding the fact that Business New Zealand would like to see assets removed as one of the criteria for classifying a company as being exempt, if the Government intends to continue using assets in this capacity, we would be supportive of a large increase in both asset and turnover thresholds, given Business New Zealand's objective of growing businesses from small-medium size to large exporting enterprises. As an owner/operator is likely to be the key person to deal with the full weight of compliance and regulation for a small business, more time is spent on these issues rather than focusing on ways to grow the enterprise. Once a company is large enough, such responsibilities can be handed over to trained in-house workers. Therefore, it is important that as many compliance costs and barriers are reduced as possible so that the transition from a small-medium sized business to a large one is easily made. A large extension of the thresholds would be one opportunity to lessen the compliance cost impacts as businesses grow in size and take up export earning opportunities. Business New Zealand wishes to see the threshold for turnover and assets be raised to the same monetary level of the Australian criteria for a small company. Therefore, we recommend that the threshold for turnover be raised to $10,000,000 a year, and that if the Government intends to continue using assets as a threshold, that it be raised to $5,000,000 a year.

Recommendation: **Notwithstanding the fact that Business New Zealand would like to see assets removed as one of the criterion for classifying a company as being exempt, if the Government intends to continue using assets as a criterion, that it be raised to $5,000,000 a year. Also, that the threshold for turnover be raised to $10,000,000 a year.**

2.9. Although we recommend that companies should become exempt from the rigors of the FRA, it is also important that there should be an obligation to prepare statutory financial statements to the existence of external users dependent on financial statements to make decisions. If a company has a number of shareholders, then any shareholder with a given voting proportion should have the right to demand the company prepare accounts to the appropriate standard. Larger companies would generally have the resources to ensure correct financial reporting, while companies that are closely held would have shareholders who have a good knowledge of the performance of the business. In contrast, a company with many 'detached' shareholders may not have an insight into the financial position of the company. Therefore, we recommend that the Australian approach of preparing annual financial statements only if shareholders with at least 5% of the vote give the company direction to do so should also be adopted in New Zealand.

Recommendation: **Obligations to prepare statutory financial statements to the existence of external users is created for those companies regarded as exempt, with the condition that financial reports are compiled if shareholders with at least 5% of the voting rights give the company direction to do so.**

3. Summary of Recommendations

3.1. The Exempt Companies Regime is removed so that companies become truly exempt from the requirements of the Financial Reporting Act 1993.

3.2. Further work is done on whether enterprises should be able to compile one set of financial records that serve all regulatory purposes.

3.3. Assets as a criterion for evaluating whether a company is deemed to be an exempt company is removed.

3.4. Notwithstanding the fact that Business New Zealand would like to see assets removed as one of the criterion for classifying a company as being exempt, if the Government intends to continue using assets as a criterion, that it be raised to $5,000,000 a year. Also, that the threshold for turnover be raised to $10,000,000 a year.

3.5. That obligations to prepare statutory financial statements to the existence of external users is created for those companies regarded as exempt, with the condition that financial reports are compiled if shareholders with at least 5% of the voting rights give the company direction to do so.