



# Governance for the SME sector — practical aspects of regulatory compliance

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- Every business should be run like a company, and every company should be run as if it were 100 per cent accountable to its stakeholders and customers
- Significant compliance obligations for SMEs, despite many enterprises not having the time, structures or expertise to comply as required
- Regulators recognise the burden on SMEs and make information available on their websites to assist in compliance

**There are many definitions to be found for small to medium enterprises (SMEs). For instance, s 128TK of the *Income Tax Assessment Act 1936* assigns a benchmark of having total assets valued at no more than \$50 million?**

Section 45A of the *Corporations Act 2001* also distinguishes small and large proprietary company. Section 45(2) defines a small proprietary as such if it satisfies at least two of:

(a) the consolidated revenue for the financial year of the company and the entities it controls (if any) is less than \$25 million, or any other amount prescribed by the regulations for the purposes of this paragraph

(b) the value of the consolidated gross assets at the end of the financial year of the company and the entities it controls (if any) is less than \$12.5 million, or any other amount prescribed by the regulations for the purposes of this paragraph

(c) the company and the entities it controls (if any) have fewer than 50, or any other number prescribed by the regulations for the purposes of this paragraph, employees at the end of the financial year.

We can also turn to the Australian Bureau of Statistics (ABS) to reveal the composition of the private sector, which helps to further define an SME. See Table 1.

**Table 1: Composition of private sector firms**

	Number of firms	Proportion
Micro-businesses (0–4 employees and self-employed)	952,200	81.80%
Small business (5–19 employees)	169,800	14.59%
Medium enterprises (20–199 employees)	39,300	3.38%
Large firms (200 or more employees)	2,800	0.24%
Total	1,164,100	100.00%

Source: Australian Bureau of Statistics, 2002, *Small Business in Australia 2001*, ABS Cat No 1321.0, Canberra, p 27. Excludes agricultural enterprises; totals may not add to due to rounding

According to the Australian Bureau of Statistics, about 68 per cent of all small businesses are home-based and typically these can be considered as family businesses.<sup>1</sup>

The OECD<sup>2</sup> defines an SME as a non-subsidary, independent firm which employs fewer than a given number of employees. The number varies according to national statistical parameters but is most frequently 250 employees in the European Union and 500 employees in the United States.

In the European Union, the size of SMEs was defined by the Commission Recommendations of May, 2003.

Within different countries you will also find reference to 'micro' enterprises with fewer than ten employees and 'small' enterprises with fewer than 50 employees, where medium enterprises have fewer than 200 employees.

SMEs typically account for over 95 per cent of firms and 60 to 70 per cent of employment and generate a large share of new jobs in OECD economies.

According to the Small and Medium Enterprise Research Centre (SMERC) at the Edith Cowan University School of Management there are two million SMEs in Australia accounting for 96 per cent of all business.

In February 2010, there were 1,734,388 companies registered with the Australian Securities and Investments Commission made up of 1,344,209 proprietary companies and 9,955 public companies limited by shares with 1,709 companies listed on the Australian Stock Exchange (ASX).

Within ASEAN member states, SMEs account for more than 96 per cent of all enterprises and 50 to 85 per cent of domestic employment where the contribution to GDP of SMEs is between 30 and 53 per cent, while the contribution to exports is between 19 and 31 per cent.<sup>3</sup>

Across the world, SMEs contribute massively to economies and employ millions.

But they may not necessarily be companies registered under the Corporations Act. In many cases when we look at the 'small' part of an SME they are sole proprietors, usually self-employed, trading under their own names or under a registered business name as a sole proprietor, under the business names regimes of each of the states.

These are the ones who typically carry the biggest burden of regulatory compliance, who are struggling to keep up with the burdens of administering their businesses, attending to clients, finding new clients and business, and then actually doing their job. And time is their most precious resource.

The sole proprietor usually *is* the business, they have all the knowledge and education and experience to carry out the specific jobs they do.

### SME governance

When someone decides to start a business, often they have a great idea and the skills, knowledge and education, drive and determination to see their idea come to life and make a successful business out of it.

Much of the time, people are so focused on doing the job that they do not set up the business structure around the job.

When a new enterprise is born, there is always the hope that it will succeed and make the owner a lot of money. We all aim for success and growth of the business. Most companies that are large now started as SMEs a long time ago.

With this vision of success and growth in the future, why not lay down the foundation stones on which the business will be built as it succeeds from the very beginning?

The old saying for any business is true no matter if it as an SME or a multinational conglomerate — plan your business

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structure now as if it was going to be 100 times bigger in the next few years.

The initial business structure should last the life of your enterprise. Future changes may give rise to unforeseen costs; for example, stamp duty issues.

For an SME to efficiently meet its regulatory compliance obligations, it should adopt proper governance principles of the highest standards and make a conscious decision to adhere to those standards so there is no room to stray from good governance. Every business should be run like a company, every company should be run as if it was 100 per cent accountable to its stakeholders and customers.

An SME should put the structures in place that will support the growth of the business.

As SMEs vary in size, so varies their ability to structure the business to allow for growth. 'Micro' businesses may not have time or the financial resources to adequately put structures for growth in place from the very beginning.

A 'medium' sized SME will have resources available to make this happen. There will usually be a board of directors to manage and guide the business, a company secretary and often a secretariat to support the functions of the company secretary.



No matter what the size of the SME, the corporate governance principles should be the same so that it will lead to open and honest decision-making with transparency and accountability.

Good corporate governance principles are now widely talked about in all companies, large and small, and governance standards are now reported in board papers and annual reports and at annual general meetings. It is now expected that companies have a corporate governance framework to report upon.

### Accelerating expectations

In the last decade corporate governance has been given increasing importance and legislated into existence in many countries. The Combined Code in the United Kingdom was one of the first codes to include principles of good corporate governance<sup>4</sup> and the Sarbanes-Oxley Act<sup>5</sup> in the United States created new standards of corporate accountability and audit reporting.

In Australia, ASX convened the ASX Corporate Governance Council in 2002, which led to the creation of the Corporate Governance Principles and Recommendations. The mission of the Council 'is to ensure that the principles-based framework it developed for corporate governance continues to be a practical guide for listed companies, their investors and the wider Australian community.'<sup>6</sup>

While these corporate governance principles were developed with reference

to listed entities, the general principles of good corporate governance can be applied to any business no matter if it is a small sole proprietor or a small to medium corporate entity. As mentioned earlier, larger SMEs have more resources to put corporate governance structures in place.

Every year since 2002 the Horwath Corporate Governance Report has been published, ranking Australia's top 250 companies on what is deemed to be national and international best practice in corporate governance.<sup>7</sup> It is a prime example of the increasing importance of good corporate governance principles and the need for investors to be assured that their companies conform to best practice.

It is interesting to note that in Australia the Parliament has not decided to legislate best practice or corporate governance principles into the Corporations Act as has been done in the United States. The ASX Corporate Governance Council Principles are guidelines that 'state suggestions for practices designed to optimise corporate performance and accountability in the interests of shareholders and the broader community'. The guidelines follow an 'if not, why not' approach to corporate governance practices.

The 'if not, why not?' approach can be applied to any SME as a guide, just as it is applied to Australia's listed companies.

### SMEs and regulatory compliance

The compliance obligations of any business are quite onerous, regardless of

its size and complexity. Just the vast array of laws that any business must adhere to are enough to justify a full-time person to be employed as a compliance officer.

Every company or business has to have a working knowledge of the Corporations Act, the *Competition and Consumer Act 2010*, Fair Trading Acts in each state, the income tax law, industrial relations legislation (both Commonwealth and the relevant state), occupational health and safety (OHS) legislation and superannuation laws.

Once the laws are known and your obligations are understood there are then the reporting requirements to be addressed. Each law imposes its own regime of reporting and a business owner must know the definitions or jargon of each different regulatory regime in order to report correctly.

This compliance and reporting obligation is more of a burden on SMEs because of the limited resources they have at their disposal. These resources are not only manifested in financial assets or infrastructure, but also resources to do with time allocation.

SMEs that are resource challenged usually find that the sole proprietor, the sole director, or the small family company end up carrying the burden of regulatory compliance.

The Corporations Act imposes strict liabilities on directors of companies no matter what their size and all directors are expected to be aware of these liabilities. These strict liabilities are put in place to ensure that companies are governed to the high standards that investors expect the stewards of their investment dollars to embody. The Corporations Act falls short of expecting every director to govern according to levels expected of professional directors of large listed companies. Rather, s 180 introduces a business judgment rule, and a 'reasonable person' test where 'a director or other officer of a corporation must exercise their powers and discharge their duties with

the degree of care and diligence that a reasonable person would exercise'.

As well as director and officer duties to be aware of, there are also time limits for reporting company changes and late fees for not reporting within the time prescribed. Most documents making changes to company details have to be lodged within 28 days of the date of change. Some documents have a shorter lodgement period.

The most common fee a company will have to pay to the Australian Securities and Investments Commission (ASIC) every year is its annual review fee. A company must pay its annual review fee within 60 days of its review date or a late payment penalty will be imposed by ASIC.

A company faces late lodgment fees and late payment fees for being outside the relevant date range.

There are a number of ways to inform ASIC of company changes within the prescribed time. A director or secretary can log onto the ASIC web page and set up an officeholders portal that allows them to inform ASIC of company changes. Alternately a director or secretary can lodge paper documents with ASIC by posting the forms or lodging them at an ASIC Business Centre.

However, with ASIC's goal to become totally paperless by 2012, it will be increasingly difficult to lodge paper documents. Traditional 'paper lodgers' will be directed towards on line functions.

The other way to lodge ASIC documents is even easier — let someone do it for you. There are many registered ASIC agents who already have the software and procedures in place to assist clients with their ASIC lodgement obligations.

An SME that is structured as a registered business name must be aware of when their renewal fee is due. If the business name lapses the proprietor could find their name taken by a competitor.

An SME, along with every business in Australia is now effectively a tax collector for the government under the obligations of the GST legislation and regulations. The regulatory compliance demanded under legislation are quite onerous and probably the biggest burden faced by many SMEs is the administration of tax collection.

*The Fair Work Act 2009* has changed some definitions of what makes up a small business. The operator of an SME has to be aware of these changes or they may end up being caught by some provisions. A business is now expected to set out certain provisions of employment that were not necessary under the WorkChoices legislation.

### Help is at hand

There are many places that an SME can turn to for assistance with its regulatory compliance obligations.

The ASIC website has many information sheets to assist a company with its post-registration obligations.<sup>8</sup> In addition, s 111J of the Corporations Act is a very helpful tool, the small business guide, setting out an SME's obligations once incorporated.

The Australian Taxation Office (ATO) also has made information available on its website to aid SME compliance.<sup>9</sup> In addition, it has comprehensive study that reflects its objective 'to increase Small and Medium Enterprises (SMEs) voluntary compliance with their tax obligations' and 'to understand their general compliance perceptions, knowledge and behaviour'.<sup>10</sup>

Both ASIC and the ATO understand the importance of SMEs to the Australian economy and they understand the weight of the regulatory burden faced by SMEs. Both are making resources available on their respective websites to assist with this burden. Giving SMEs the assistance and encouragement to be able to comply is much more effective and economical than prosecuting SMEs that fail to comply. ASIC has a compliance and deterrence team to assist companies with their reporting obligations.

# Key Issues Applied Corporate Governance

Specialist organisations and industry groups can also be found to assist SMEs with their compliance obligations.

Industry associations, guilds and networks are the most useful place for an SME to find assistance in their specialised field.

One of the most confusing aspects of SME regulatory compliance is the difference in terms and definitions between government departments. Words that mean one thing to a particular department will mean something else to another department. This makes reporting unnecessarily difficult for the SME.

At the moment there is a whole-of-government (across departments and between state and federal governments) approach to standardise reporting terms and definitions to make compliance a little less confusing. One of the major hurdles of the SBR project was to standardise the taxonomy of the forms so that definitions were consistent across departments. The Standard Business Reporting (SBR) project was initiated five years ago and is a long-term project to reduce the business-to-government reporting burden. It was estimated that the project would take ten years to implement and would save Australian businesses \$800 million per year once fully implemented.

## Get in early

As mentioned earlier, it is very important that an SME set up the correct structure for its needs from the very beginning. For example, a business name may be all that is required but the proprietor is 100 per cent liable for the actions of the business so it may be necessary to put some legal protection in place, such as registering a company, depending on the activities of the SME.

The SME may need special structures for asset protection or tax effectiveness, or to take into account the family situation of the owners or directors.

The SME should seek legal advice and accounting advice to set up the structure that best suits its needs.

There is so much for the SME to know about the running of their enterprise that they cannot possibly be expected to know everything. The smaller the SME the more likely it is not to know every aspect of its regulatory obligations because of the pressures of time.

There are many good reasons for an SME to seek the assistance of outsourcing agents or companies to help relieve them of their compliance needs. The SME can then focus on its core business and concentrate on what they do best.

There are many companies that specialise in providing corporate secretarial services, taxation advice, legal advice, industrial relations advice and OHS guidance. They actively assist the SME with its compliance obligations.

## Conclusion

Just to define an SME is a major task because of the many definitions used by different organisations and government departments. The Parliament of Australia Joint Committee on Corporate and Financial Services which reported on 28 April 2011 on the inquiry into access to finance for SMEs made mention of the many different definitions used by the Reserve Bank of Australia, Treasury, ABS, separate pieces of legislation and banks. This absence of a uniform definition of SMEs directly restricts SMEs' access to finance.

One thing commonly agreed upon is the huge importance of SMEs in the Australian economy as the major engines of growth and employment.

The corporate governance of SMEs is just as important as the corporate governance of listed public companies considering their importance to the Australian economy.

Every effort should be made by regulators and legislators to ensure that corporate compliance obligations of SMEs are made less burdensome so that they can continue to grow the economy by concentrating on their core responsibilities.

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## Notes

- 1 Australian Bureau of Statistics, 2005, *Characteristics of Small Business 2004*, Cat No 8127.0, Canberra, p 70. Excludes agricultural firms
- 2 OECD Policy Brief, 2000, *Small and Medium-Sized Enterprises: Local Strength, Global Reach*
- 3 ASEAN Economic Community, 2003, *SME Developments in ASEAN*, ASEAN SME Advisory Board
- 4 The UK Corporate Governance Code and associated guidance, Financial Reporting Council, 2003 at <http://www.frc.org.uk/corporate/ukcgcode.cfm>
- 5 The Sarbanes-Oxley Act of 2002 (often shortened to SOx and named for its sponsors Senator Paul Sarbanes and Representative Michael G Oxley)
- 6 ASX Corporate Governance Council, 2010, *Corporate Governance Principles and Recommendations with 2010 Amendments, 2nd Edition*, at <http://www.asx.com.au/governance/corporate-governance.htm>
- 7 Psaros J and Seamer, M, 2009, *Horwath Corporate Governance Report*, The University of Newcastle, Faculty of Business and Law, Newcastle Business School, [www.newcastle.edu.au/school/business/research/horwath/](http://www.newcastle.edu.au/school/business/research/horwath/) [27 May 2011]
- 8 See [www.asic.gov.au/asic/ASIC.NSF/byHeadline/Running%20your%20company](http://www.asic.gov.au/asic/ASIC.NSF/byHeadline/Running%20your%20company) [27 May 2011]
- 9 See [www.ato.gov.au/corporate/content.aspx?doc=/content/00169210.htm&mnu=47055&mfp=001](http://www.ato.gov.au/corporate/content.aspx?doc=/content/00169210.htm&mnu=47055&mfp=001) [27 May 2011]
- 10 Sweeney Research, 2010, *Understanding the small and medium enterprise market*, <http://www.ato.gov.au/youth/content.aspx?doc=/content/00261913.htm&pc=001/001/024/002&mnu=39508&mfp=001/013&st=&cy=> [27 May 2011]
- 11 <https://www.sbr.gov.au/content/public/about> [27 May 2011]. See also Daniels J, 2008, 'A changed reporting landscape — XBRL' *Keeping good companies*, Vol 60 No 6, pp 333–337 ■