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Principal Adviser
Corporations Policy Unit
Consumer and Corporations Division
The Treasury
Level 5, 100 Market Street
SYDNEY NSW 2000

14 December 2018

By email: reportingthresholds@treasury.gov.au

Dear Ms O'Rourke

Reducing the financial reporting burden by increasing the thresholds for large proprietary companies

This joint submission is made on behalf of members of the Australian Finance Industry Association (**AFIA**), the Australian Institute of Credit Management (**AICM**) and the Australian Restructuring Insolvency and Turnaround Association (**ARITA**), collectively referred to as **the Associations.** Further detail on each Association is provided at the end of this submission. Our general position follows and evidence to support is outlined in the attachment.

While representing different market segments and components of the financing transaction, the Associations have common ground in their support of a fair, sustainable and competitive market for small and medium-sized business owners to be able to access affordable finance. A policy position we understand is also held by the Government.

A key component of achieving this is for the provider to be able to assess and manage credit risk including when the business owner may get into financial difficulty requiring external intervention. Access to data, including financial statements or reports of small and medium-sized business borrowers, is integral; as is access to other relevant data.

Consequently, the Associations have been strong supporters of various Government initiatives designed to improve transparency and increase data availability for good decision making. These include open banking, mandatory comprehensive credit reporting and the new lease accounting standard. Enhancing data availability for automated credit-decisioning facilitates providers of finance meeting both their customers' demand for a fast-turnaround and the need to make prudent and soundly based credit decisions. The outcome for small and medium-sized business owners is that they will have:

- the working capital, trade credit or other finance they need to start or grow their businesses,
- when they need it; and
- provided in a cost-effective manner.

These initiatives underpin access to finance objectives by enhancing the ability of FinTech lenders and others to maximise the value of digital technology that differentiate them from other market participants.

Further, the Associations are aligned in their support of the Government's policy of red tape reduction in particular for small and medium-sized businesses with the flow on benefits in efficiency and cost-reduction. We understand this policy objective underpins the proposed changes to the *Corporations*

Regulations 2001 to reduce financial reporting obligations on small and medium-sized business owners.

However, the Associations are concerned that in seeking to reduce red-tape, the Government is potentially putting at risk access to affordable credit by small and medium-sized business owners.

More specifically, the Associations are concerned that the huge potential from open banking and mandatory credit reporting for enhancing competition and enabling greater access by small and medium-sized business owners to finance will be devalued by the Government's proposal to reduce the financial reporting burden. This is because the information contained in financial reports is key data that underpins current credit-decisions. The ease of access of financial reports impacts the ability of a financier or trade-creditor to be able to make automated or real-time finance-decisions. By reducing red-tape in financial reporting for some of these entities, the Government would be potentially increasing the time taken, or the data-available to make sound finance decisions. The outcome for a small or medium-sized business owner may be either that they:

- pay more for credit; or
- are declined credit because of information asymmetry and lack of data availability on which to base a credit decision rather than issues around serviceability or character.

Neither outcome is useful for the small or medium-sized business owner or the financier / trade creditor or the Australian economy.

Associations Recommendation:

The Associations are united in our **strong recommendation**:

- that the Government does not change the monetary thresholds for financial reporting. To increase the monetary thresholds puts at risk access to affordable finance by small and medium-sized business owners. The current levels should remain unchanged.

Evidence to support our position is provided in the attachment.

We would welcome the opportunity to meet with Treasury to discuss our position further to inform the Government's consideration.

Kind regards

Helen Gordon	Nick Pilavidis	John Winter
Chief Executive Officer – AFIA	Chief Executive Officer – AICM	Chief Executive Officer – ARITA

The Associations:

AFIA represents the interests of over 100 financiers, credit providers and industry participants, including credit reporting bureaus.

AICM represents the interests of over 2,500 credit professionals responsible for maximising the cash flow and minimising the bad debt risk of companies in a vast array of industries.

ARITA represents the interests of over 2,000 insolvency professionals, including approximately 84% of registered liquidators.

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Our specific reasons follow:

1. ***Reducing transparency of these businesses*** – Credit providers rely heavily on the publicly available reports to provide an efficient and reliable source of information including financial viability, company structures and significant stakeholders.

   Inability to easily access relevant information is one of the barriers to small business access to credit. Increasing the thresholds and reducing readily available and key financial report information will exacerbate this issue.

   Without this information the credit providers will be less able to respond to expectations of immediate approvals utilising automated credit-decisioning processes as manual requests for information and assessment will be required.

2. ***Reduced access to credit*** – the Associations have identified that the reduction of transparency will lead to significant impacts on businesses accessing credit and notes the following to assist quantifying the scale of the issue:
   - *"In Australia, trade credit owed by Australian businesses (both listed and unlisted corporations) is estimated to have been over $80 billion in March 2013 (see RBA)"*
   - A market leader in business data, Equifax, advises:
     - *When assessing businesses with sales revenue greater than $5m, financial statements provide a 50% uplift in predicting default (across businesses in the highest quartile of risk).*
     - *72.5% of enquiries relating to financial statements (of entities having a financial reporting obligation) come from non-banking customers.*

   This highlights the importance of financial statements to the provision of trade credit and finance more generally for small and medium sized business owners

   Should the financial reporting thresholds be raised, Equifax have identified that 17,200 companies will no longer lodge reports. Currently when these entities apply for credit or finance a significant proportion of credit assessments could be completed via automated means utilising the publicly available financial data with minimal intrusion on the company for additional details.

   Should the thresholds be increased, the lack of publicly available information will require one or more of the following steps to be taken by AFIA and AICM members:
   - Declining the request on the grounds that sufficient financial information is not available to support the credit application. This would kick in at various exposures.
   - Requiring the customer to provide audited financial reports
   - Requiring the customer to provide management accounts
   - Requesting director/personal guarantees
   - Requesting additional security e.g. caveats over real property
   - Providing credit on reduced terms than that generally offered in the industry

- Providing a lower credit limit than required

These responses would result in the following impacts for the businesses:
- Reduced bargaining power with current suppliers as ability to switch is reduced
- Increased personal liability for directors/owners
- Less access to credit to drive growth and/or bid for new projects/contracts

3. ***Absence of information leads to a negative bias.*** Audited financial reports provide a highly reliable source of information and therefore provides confidence in credit decisions. Without this reliable information credit providers will take an adverse assumption leading to a restriction in credit or credit being provided on more restrictive terms.

4. ***The population of entities impacted is much greater than the 2,200 stated in the joint media release***. Analysis by Equifax indicates that the proposed increase in thresholds will reduce the total number of mid-sized companies publishing financials by 17,200 (being 83% of the 20,700 unique businesses currently required to lodge reports).

5. ***Less oversight of business and accounting practices*** – Entities over the existing thresholds have significant impacts on a range of stakeholders in addition to credit providers. This includes tax payers, other businesses in the supply chain and employees.

   The requirement to produce audited financial accounts provides a strong motivator for compliance with accounting standards forming the basis for sound decision making and governance.

6. ***Increasing incidence of insolvency and insolvent trading –*** Independent overview by Auditors of the financial performance of organisations provides a mechanism for businesses experiencing early warning signs of insolvency to be highlighted and corrective action taken in a proactive manner such as engaging with appropriately accredited insolvency professionals and utilising initiatives such as the Safe Harbour defence to allow orderly restructure.

7. ***Contrary to other jurisdictions*** - AICM has received commentary from the Chartered Institute of Credit Management (CICM) in the United Kingdom who note:

   "All private limited and public companies must file their accounts at Companies House with the exception of small and Micro-entities who may prepare an abridged version if they meet two of the following conditions, which were reviewed as recently as 2018:
   - *annual turnover must be not more than £10.2 million ($17.93 AUD)*
   - *the balance sheet total must be not more than £5.1 million ($8.96 AUD)*
   - *the average number of employees must be not more than 50"*

   Considering the UK is a similar jurisdiction, using similar types of thresholds and has recently reviewed the thresholds it is significant that the Australian thresholds are currently significantly higher.

8. ***Contrary to the open banking and mandatory credit reporting initiatives.*** Increasing the thresholds is clearly contrary to these objectives aimed at increasing the data to fuel credit assessments.

9. ***Current thresholds are an appropriate definition of an economically significant entity -*** Businesses meeting the current thresholds are deemed to be economically significant entities in the opinion of the professional bodies and their members. These thresholds indicate the

businesses will have multiple stakeholders reliant on the financial reporting and economic viability of these entities including but not limited to their employees, suppliers, financiers, minority shareholders and customers.

10. ***$300 million cost savings unlikely to be realised*** **-** Greater cost associated with a reduced access to credit and increased requirement to provide security is likely to exceed any savings from "removing the reporting burden" (joint press release). Further many entities will still need to incur the reporting costs to satisfy obligations to primary financiers and other significant stake holders.

11. ***Restriction of fintech Innovation –*** Access to publicly available data is vital to fuelling innovation in the Fintech space and provide further efficiencies to credit assessment and access to finance.