ACCA

Protecting stakeholder interests in SME companies

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This report discusses how four different countries – the UK, the US, Australia and Singapore – see the role of accounting information in protecting third-party interests in SME companies.

The scale of the compliance burden imposed on SMEs is being re-assessed in many countries with the aim of freeing up smaller firms from red tape. When SMEs are limited companies, the danger is that reducing the regulatory burden for the businesses concerned will lead simultaneously to a reduction in safeguards for the shareholders and creditors of those businesses.

Foreword

There is little doubt that SMEs are now the major driving force for enterprise and employment growth in most developed economies. It is plainly in the interests of governments to encourage the creation and expansion of SMEs, especially in those countries that are experiencing severe debt conditions and are placing considerable trust in the ability of the private sector to return their economies to growth.

This process of encouraging the SME sector to prosper is very often accompanied by calls for the regulatory burden to be reduced to the minimum so as to cut compliance costs for smaller businesses and to free their managers' time to do what the firms were set up to do. Very often these calls come from SMEs themselves. In many cases they are justified in arguing that the regulatory burden they bear is too heavy.

What complicates the situation, particularly at the SME level, is that, where a business enjoys limited liability status, the individuals behind that business are generally able to take shelter from the consequences of their own poor or reckless decisions and initiatives, while those third parties who deal with them, including trade creditors, employees and government departments, are left to count the cost.

Invariably, jurisdictions will impose conditions on the conduct of business by limited liability companies so as to deter abuse of the system and to compensate third parties for the risk they run in doing business with companies.

The issue that this report addresses is the extent to which legal rules on accounting and the public disclosure of financial information act, or should act, to deter abuse of the corporate format and to compensate for third-party risk at the SME level. The report examines the practices of four major jurisdictions and compares and contrasts the weight attached to these matters in their respective frameworks for regulating small, privately held companies.

The report is intended to provide a balanced view of how the costs and benefits associated with accounting and disclosure are reflected in national frameworks, all of which are striving to achieve a balance between protecting stakeholder interests and reducing unnecessary levels of regulation.

Faris Dean
Chair
ACCA Global Forum on Business Law

1. The UK

THE SMALL BUSINESS ENVIRONMENT IN THE UK

As of January 2012, there were an estimated 4.8m small and medium-sized enterprises (SMEs) in the UK, accounting for 99.9% of all enterprises in the country (UK House of Commons Library 2012). Together they accounted for nearly 60% of private sector employment and 49% of private sector turnover. Small enterprises alone (defined as those with fewer than 50 employees) accounted for 46% of private sector employment and 35% of turnover. Collectively they employed an estimated 14m people and recorded a combined annual turnover of £1.5 trillion.

The number of business enterprises in the UK has increased significantly in recent years. The total has risen by 39% since 2000, virtually all this growth being driven by SMEs – their numbers have risen from 3.5m in 2000 to 4.8m in 2012. Over the same period the estimated number of 'large' private sector businesses has decreased from 7,200 to 6,300.

Only a minority of SMEs in the UK benefit from the protection of limited liability. Of the 4.5m enterprises in 2011, 28% were corporate bodies of one kind or another, 62% were sole traders and 9% were partnerships. Since only corporate bodies are required by law to prepare and publish annual accounts, and comply with other legal rules regarding financial management and administration, this means that the great majority of enterprises in the UK already operate outside the framework of company law.

There has been a significant increase in the number of enterprises without employees: at the start of 2012, 74% of all private sector businesses (3.6m enterprises) had no employees at all. These enterprises, collectively, had an estimated turnover of over £200bn. Companies are more likely to have employees than unincorporated businesses: in 2012, 59% of the 1.3m companies had employees, as opposed to 35% of partnerships and only 10% of sole traders.

The importance of the SME sector, in terms of its contribution to business activity, turnover and employment, has been acknowledged by successive UK governments. Its role has taken on even more political significance given the aftermath of the financial crisis of 2007–8, which has resulted in substantial cutbacks in public sector spending and employment. The UK government, in common with other countries in a similar position, has invested great hopes that the private sector, especially the SME sector, can lead the way back to economic recovery, and so has embarked on a number of high-profile initiatives to try to encourage enterprise and growth.

When it came to power in 2010, the new coalition government declared its commitment to providing more opportunities for SMEs to win central government procurement contracts – it set itself a target of increasing the SME share of such business from 6.5% to 25% by 2015. It committed itself to reducing the overall burden of regulation for all UK businesses but especially for SMEs (which are widely viewed as suffering disproportionately from regulation because of their comparative lack of administrative resources). With a view to achieving this target, it instigated a project to review all existing regulations and to invite feedback from businesspeople and individuals across the country as to which specific regulations should be withdrawn. Part of this project involved a pledge not to introduce any new regulations until it had deleted existing ones. It also initiated a review of enforcement practices, again inviting feedback on examples of inappropriate or excessive enforcement of regulation, with a view to reforming them or eliminating them.

Thus, the SME sector occupies a key position in the UK economy, a position which has assumed a heightened profile as a result of the national and international economic crisis. The drive to reduce regulatory burdens of various kinds, as a means of encouraging growth and employment, has become a key feature of this environment.

In the World Bank's index, *Doing Business 2013*, published in October 2012, the UK ranked seventh out of 185 countries for the ease of doing business.

CORPORATE FORMATS FOR SMES

As already indicated, over two-thirds (71%) of SMEs in the UK operate as unincorporated bodies. For those that choose to incorporate, the principal options available are as follows.

1. Private company limited by shares

This is the most popular option for SMEs that wish to trade as companies. The great majority of companies are private, and the great majority of them are 'small' (the primary test for this, at the time of writing, is having turnover below £6.5m). Despite the fact that most companies are now 'small' and owner-managed, the fundamental assumption in UK company law is that in every company there is a division of responsibilities between the shareholders who own the company, and the directors who run it. This assumption still by and large applies in relation to the private company, and there is still an onus on the directors to be accountable to the shareholders, even if they happen to be one and the same.

A private company can be formed easily by submitting the required documentation to the UK companies registry, Companies House. A private company needs only one member and one director. Unlike the public company, there is no minimum capital requirement, so a private company can be formed with capital of £1. The 'private' character of this form of company means that it may not issue shares to the general public: this distinguishes it from the 'public' company which may do so, and which as a consequence is subject to a more extensive compliance regime.

Once incorporated, a private company limited by shares becomes a separate legal person and its individual members are only liable for the company's debts and obligations to the extent that they owe money to the company for their shares in it.

It also assumes responsibility for complying with the legal requirements of the Companies Act on a wide range of issues, including the conduct of directors, the basis on which profits are determined and may be distributed, and the information that must be submitted to the authorities and otherwise publicised by the company.

In an attempt to ease the regulatory burden for SMEs, however, reforms made by the Companies Act 2006 mean that a number of statutory compliance obligations that previously applied to private companies no longer do so. For example, a private company need no longer:

- have a company secretary
- hold an annual general meeting
- convene general meetings of shareholders to pass company resolutions.

2. Private company limited by guarantee
This format is most commonly used by charities and other non-trading bodies, notably clubs and associations. The only substantial difference between this format and the preceding one is that the members' 'guarantee' replaces the liability of members for amounts unpaid on their shares. The guarantee is the sum of money, usually a nominal amount, which each individual member of the company agrees to pay, in the event of the company's liquidation, as a contribution towards paying off its debts.

3. Unlimited company
An unlimited company is still a company, in the sense that it has its own separate legal personality, but its members do not benefit from limited personal liability for the company's debts and obligations. This is widely seen as a major disadvantage. These companies do, however, benefit from an exemption from the standard legal requirement for companies to file their annual accounts with Companies House (although they are still subject to the standard UK legal requirement to prepare accounts).

4. Limited liability partnership (LLP)
The LLP is a hybrid form of entity, in that it combines characteristics of both the limited company and the partnership. Thus, the LLP is a corporate body, and is subject to many of the compliance requirements of the Companies Act, but at the same time it resembles a partnership in that the internal management arrangements of the LLP are left to the individual partners to decide and these partners are taxed on their personal income. While businesses of all sizes are eligible to become LLPs, the format is most associated with large professional firms that wish to limit the personal liability of their individual partners. As of 2011, there were about 43,000 LLPs in existence in the UK.

With the exception of the LLP, UK companies, regardless of size, are taxed on their corporate profits, and their annual accounts form the starting point for this calculation. Individual directors and shareholders are taxed on their individual earnings, both from the company and any other source of income.

PUBLIC ACCOUNTABILITY

UK law has for many years imposed extensive requirements on companies of all types and sizes to keep proper accounting records and to prepare and publish annual financial statements and other prescribed information relating to their operations. The requirements on these matters exist within the context of a much wider body of law that applies to limited companies and that covers matters such as maintenance of share capital, shareholder communications and distributions of profits.

The rationale for imposing accounting and disclosure requirements on companies has always been that it is in the public interest for companies to be subject to standardised regulation in these matters to balance the special legal privileges that flow from the award of limited personal liability to company owners. The rationale can be explained in the following terms:

- A company should be required to manage its financial affairs in specified ways that respect and reinforce the separate legal personality of the company.

- Given the separation, under company law, of ownership and management, rules are needed to protect the interests of the former and to clarify the responsibilities of the latter.

- Since the persons who own and control companies will not be personally responsible for their company's debts, rules are necessary to reduce the risk that third parties assume when doing business with them.

The main statutory requirements for UK companies in the area of accounting and disclosure are as follows.

1. Maintenance of books and records

All companies are required to keep records of their accounting transactions that are sufficient to enable the company's directors to prepare annual accounts that satisfy the legal test of giving a true and fair view. Records must be kept for prescribed periods (three years for private companies and six for public companies).

2. Filing of an annual return

Every company must complete and file with Companies House an annual return, which gives information about the company's directors, shareholders and share capital.

3. Preparation of annual accounts

Every company, through its directors, must prepare annual accounts for each financial year and make these available to its shareholders. (Annual accounts prepared to the required standard are additionally used as the basis for the computation of a company's tax liability.) If a company has subsidiary companies it is subject to an additional requirement to prepare group accounts. In both cases, the accounts must include a balance sheet, profit and loss account and notes containing prescribed additional information. The accounts must be prepared in accordance with the standard formats and information disclosure rules set out in regulations made under the Companies Act (which are in turn based on the requirements of EU legislation). Fundamentally, each set of annual accounts must give a 'true and fair view'. That latter term is not precisely defined in statute, but UK case law has established that a true and fair view requires disclosure of all the information that is demanded by the law and compliance with the rules on measurement and valuation that are set out in applicable accounting standards (either UK GAAP or IFRS as the case may be). If a company's directors approve a set of annual accounts that do not comply with the disclosure requirements of the Act, and they either know this is not so or are reckless as to whether it is or not, they commit an offence.

4. Audit

Between 1900 and 1995 all UK companies were required by law to have their annual accounts independently audited. There are now extensive rules, again governed by EU legislation, on who may act as an auditor and how such persons are to be regulated. The audit report is required to give an opinion on whether the accounts give a true and fair view, comply with the Companies Act and have been properly prepared in accordance with the chosen accounting framework. Where an audit is carried out, the audit report must be delivered to Companies House along with the annual accounts. (As explained further below, the public interest rationale for requiring an independent audit in all cases has been re-examined in recent years in the light of the rising number of very small and owner-managed companies and developing ideas about whether cost-benefit considerations should override considerations of public interest in the case of smaller companies with fewer stakeholders).

5. Publication of annual accounts

When finalised, the annual accounts of each company (together with the audit report) must be delivered to Companies House within prescribed deadlines (nine months from the accounting year end in the case of private companies and six months for public companies.) There are fines for late delivery.

The compliance regime is thus supported by a comprehensive database of statutory information on all registered companies – regardless of size – which is maintained by Companies House. The great majority of the documents that companies are required to file with Companies House do not require a filing fee. Any individual or business is able to access the database, online, by post or at designated search offices around the UK. By doing so they can easily obtain copies of any company's published accounts and details of its constitution, directors and shareholders. The easy availability of information on the public record also provides material assistance to banks, accountants, lawyers and all other categories of person who have obligations under the UK's anti money laundering legislation to acquire discreetly the client information that they need in order to perform their client due diligence checks.

ADDITIONAL LEGAL MEASURES THAT PROTECT STAKEHOLDER INTERESTS

In keeping with standard international norms, UK company law recognises a clear distinction between the company as an entity and the persons who are its shareholders and directors.

Therefore, as a rule, the activities, profits and liabilities of the company are considered to be wholly separate from those of its owners and managers, unlike the position in unincorporated bodies, where unpaid debts run up by a business can be pursued against the proprietor(s) personally. Directors of UK companies enjoy considerable protection in respect of their companies' liabilities and the circumstances in which they can be held personally responsible are restricted.

Thus owners and directors of companies can shelter behind the company structure, and persons dealing with a company run a higher level of risk of not being paid. By providing transparency about the company's financial affairs, mandatory rules on accounting and auditing are one way in which UK company law tries to compensate stakeholders for this risk. Other measures designed to safeguard stakeholder interests, especially in the SME context, include the following.

- As mentioned above, a wide range of information about each company's constitution, registered office, directors, shareholders and capital structure is required to be placed on the public record and made available for inspection by any interested party.
- Company directors owe a number of specific statutory duties to the company's members, including a duty to act with skill and care. Failure to comply with these responsibilities may lead to civil action against them by the members.
- Company directors who breach their duties under the law or are otherwise deemed to be 'unfit' can be disqualified from acting as directors for up to 15 years.
- Where a company pays an illegal dividend to its shareholders, or makes some other form of distribution of capital that is not permitted by the Companies Act, each member who receives an illegal payment is liable to repay it.

Where a company becomes insolvent and has to be wound up, directors may be made personally liable for debts they have run up when they have traded fraudulently or 'wrongfully' (ie where they have incurred debts when they knew or should have known that the company would not survive) or where they have committed misfeasance.

In addition to the above, the law lays down a large number of criminal offences for breach of statutory responsibilities, which can be viewed as authoritative incentives for companies to respect the interests of their shareholders, in particular, and in some cases creditors as well. For example, directors may commit criminal offences if they approve annual accounts that do not comply with legal requirements, if they fail to keep minutes of their meetings, and if they fail to provide information to their company's auditor on request. In some circumstances, a company's shareholders may be able to bring legal proceedings, in the name of the company, against their directors.

A stakeholder protection of a wider character is represented by the fact that not only auditors but also all accountants who are appointed to provide business support services to businesses have legal responsibilities under the Proceeds of Crime Act. Given that 83% of small companies are believed to consult an external accountant for accounting or business advice (Bennett and Robson 1999) this means that the great majority of companies will be covered by these provisions. Under the Proceeds of Crime Act, accountants and auditors, like certain other professionals, are expected to be alert to signs of the processing of the proceeds of crime and of the financing of terrorist activities in the affairs of their clients, and to report to the authorities where they suspect that either is happening.

BUSINESS RELEVANCE OF ACCOUNTING AND AUDITING AT THE SME LEVEL

Much of the attention that has been paid in the UK to accounting and auditing during the economic downturn following the banking crisis of 2007–8 has focused on whether the costs of statutory rules on retrospective reporting outweigh the benefits, and therefore represent a drag on the ability of businesses to go about their business and achieve growth.

In favour of mandatory rules on accounting and disclosure, there is evidence that annual accounts and the information contained in them are useful to stakeholders, especially to lenders and tax authorities. Lenders typically use published accounts to assess lending and credit risk, ordinarily making the supply of funding conditional upon the provision of financial information, while tax authorities use accounts prepared under Companies Act rules as the basis for the assessment of tax liability. A survey undertaken for the UK government showed that 67% of SME companies surveyed regularly sent copies of their accounts to their bank and other lenders; 56% thought that the accounts they filed at Companies House were likely to be useful to users (Collis 2008). As to who those other users might be, they were found to be mainly trade creditors and credit rating agencies.

The Institute of Credit Management, a trade association which represents the interests of internal credit managers, said in 2011, when commenting on a government proposal to reduce the amount of financial information required to be published by the smallest companies:

> Our position has always been, and remains, that information is a vital element for businesses in managing themselves, and for trade credit practitioners and suppliers in reaching informed decisions about the granting of credit. Reducing the information available will, in our view, only ever have one outcome, a restriction in the amount of credit available and – as a consequence – a stifling of growth and economic recovery.

In 2011/12, nearly 6m searches were made of company information held by Companies House: while this figure will have included searches of information other than accounting information (Companies House Annual Report 2012), a substantial proportion of those searches are likely to have focused on accessing annual accounts. A separate estimate suggests that around 935,000 sets of published small company accounts are accessed each year (Kitching et al. 2011).

This is not to say that those who run companies in the UK are uniformly happy to publish information about their firm on the public record. Directors of small and medium-sized companies are entitled by law to file with Companies House abbreviated versions of their full accounts, in which they are entitled to withhold certain information, and between 50% and 60% do this (POBA 2006). Studies have found that avoidance of public disclosure of potentially sensitive business information is one of the principal reasons why SMEs choose to file abbreviated accounts. Many companies that file abbreviated accounts are likely to do so in order to avoid disclosing information that might be used to their disadvantage: for example, they may fear that suppliers might raise prices, employees might seek higher salaries and customers might seek discounts if they believed that the company was successful. The consequence of filing modified information, however, is that there is a reduction of transparency on the public record. Where only abbreviated information is made available, prospective lenders may act more cautiously, and may be motivated to require additional information before making a decision on a loan, credit rating or insurance policy. This is an indirect argument for making available the full financial statements rather than a modified version.

Another argument that is frequently presented to justify mandatory accounting rules (and associated legal requirements to keep adequate accounting records) is that they encourage financial discipline, which in turn acts as an indirect safeguard for companies' shareholders and creditors. The deadline imposed for filing a set of accounts at Companies House is seen as another strong incentive to ensure correct financial management, in that it acts as a spur to companies to prepare their accounts in good time: failure to file annual accounts on time is often seen as a warning sign of internal problems, in particular that the company has not been able to agree its accounts. Were company directors to be freed from any obligation to report on their financial affairs on a regular basis, some suspect that their companies would find it more difficult to win and retain business and to access finance, because the risks associated with doing business with them would increase. It may also be that poor behaviour on the part of some directors of small companies would translate into a reduction in confidence in smaller companies more generally, to the detriment of the wider business community.

DE-REGULATION OF COMPLIANCE OBLIGATIONS FOR SMES

Increasingly, since the 1980s, there have been initiatives at the political level in the UK to reduce the compliance burden on smaller companies so as to make such burdens more proportionate to the perceived usefulness of that information to stakeholders. In the early 1980s, UK law was amended to allow SME companies to file with Companies House the 'abbreviated' versions of their full accounts mentioned above – these abbreviated versions allow companies below a certain size to disclose on the public record a reduced range of information. At the same time, SMEs were afforded a series of exemptions from the standard disclosure requirements for their full accounts. These changes were made on the basis that the shareholders and other stakeholders in smaller companies did not generally need the same amount of information and level of detail as their equivalents in the case of large companies. Neither development affected the basic obligation that companies of all sizes have to prepare and publish annual accounts.

The accounting disclosure rules were not changed in substance when the UK reformed its companies legislation in 2006, but an important presentational change was made in that, instead of setting out the standard disclosure rules followed by a list of exemptions for small companies, the law for the first time set out a stand-alone list of dedicated requirements for small and medium-sized companies. This was part of the UK government's strategy of 'Think Small First', whereby it attempted to re-present companies legislation in a way that was more appropriate for the vast majority of limited companies, which were by this time small private companies. At the same time, and in keeping with the same strategy, a number of other changes were made to the legal rules on company administration with a view to making things less bureaucratic.

In 2012, the EU agreed a change to EU law on financial reporting by introducing a new category of 'micro company' (the principal defining criterion of which is to be turnover not exceeding 700,000 euros). Companies that meet the definition of 'micro company' may be permitted by member states to file on the public record an even more limited range of information about their financial affairs than is currently expected of small companies. The UK government has indicated that it will implement this change in the UK in due course.

From the mid-1990s, a major re-think has taken place about whether smaller companies should be required by law to have an independent audit. This has taken place in the context of EU company law, which allows member states to exempt from audit companies that are classified as 'small' by reference to prescribed criteria. In 1995, the law was changed to exempt private companies with a turnover of up to £90,000 from the audit requirement. By 2012, following a series of incremental rises in the exemption thresholds, companies with a turnover of up to £6.5m had become exempt (although, as a safeguard, 10% of shareholders may still insist that an audit be undertaken). This has meant that the great majority of the UK's small companies now do not have their accounts audited. The number of companies exempt from audit is likely to rise still further in the light of changes to EU legislation expected in 2013, which will increase the applicable exemption thresholds.

Another significant reform which the UK government has made in 2012 is to take advantage of the opportunity provided by existing EU law to exempt all subsidiary companies – whatever their size or type – from audit, provided that a number of specified conditions are satisfied, the most important of which is that the parent company guarantees the debts of the subsidiaries.

The changes that have already been made thus have the effect of modifying the long-standing assumption in UK company law that all companies should be required to meet public-interest-orientated obligations in the same way. The prospective changes referred to above would continue that trend. There is now a greater recognition, at the official level, that the law, as it applies to external reporting by SMEs, should be calibrated to take into account the likely usefulness of information to third parties, as well as the cost-benefit implications of preparing and disclosing that information, especially in the case of the increasing number of owner-managed companies, where, arguably, the need for directors to be accountable for their actions to their shareholders is less evident. In the case of audit, the principle has been adopted that, where a company is 'small', and is consequently likely to have a limited number of stakeholders, the public interest case for insisting by law that an audit must be carried out is no longer strong, and for those companies, the decision as to whether or not to have an audit is best left to shareholders to decide. Accounting and audit has in fact been one of the key areas of focus on the part of the UK authorities in their drive to reduce business burdens in the SME sector.

Despite the inroads that have been made on external reporting requirements, it nonetheless remains the case that UK law still contains a high level of direction as regards corporate conduct, and the requirements relating to the public availability of accounting and other information are still widely seen as serving twin goals – providing incentives for 'good' corporate behaviour on the one hand and protecting the interests of shareholders and creditors on the other.

SUMMARY

While there are frequent calls for legal obligations of all kinds to be reduced for SMEs, in order to achieve savings in cost and time, the UK company law compliance regime, as modified by the Companies Act 2006, remains very attractive to small private companies. The associated compliance burden, including the record-keeping and accounting requirements, does not appear to be deterring the incorporation and maintenance of small private companies and, as outlined above, there is evidence that the regime produces business-useful information for third parties, even at the SME level.

The rationale for the UK's rules on company reporting has for many years been based largely on the idea that companies, as a condition of having limited liability status, should be required to prepare accounting information on a standardised basis and to make that information public, both as a regulatory control measure and in order to provide information about their activities that might be of practical value to third parties, including creditors and prospective trading partners. The regime ensures that extensive information about companies' activities is placed on the public record for anyone to inspect. Failure to comply with filing requirements is seen as a serious matter which can result in civil and criminal sanctions for the company and its individual directors.

With respect to the rules as they apply to small and private companies, however, the relative importance of the element of providing business-useful information to the general public is declining. This is because the modified disclosure requirements that small companies are entitled to follow when publishing their accounts on the public record, and which most of them choose to adopt, result in the publication of a great deal of information that is not widely seen as being of practical business value to third parties. This trend towards allowing only minimal accounting information to be filed is likely to continue following the changes to EU law that will entitle member states to allow a new category of 'micro' company to file a yet smaller range of accounting information on the public record. The same trend towards reduction of reporting obligations for small private companies is also seeing the independent audit disappear as a control device for such companies. As a result, the reporting requirements for small companies are increasingly prioritising owners' demands for information privacy over the cause of transparency. Consequently, their purpose, arguably, is becoming less to provide business-useful information to third parties and more to achieve regulatory aims.

The UK compliance regime continues to contain some important elements for protecting the interests of stakeholders in small private companies. Shareholders and creditors are entitled, via the regime, to expect directors of companies of any size to exercise a measure of discipline in their financial management and to have prepared annual accounts that meet the requirements of the Companies Act and UK GAAP. Interested third parties, particularly minority shareholders and lenders of finance, can therefore insist on inspection of those detailed accounts for their own purposes. Even where modified information is filed on the public record, that information will be derived from the full accounts (which form the basis for computing the company's tax liability). The availability on the public record of information about companies' financial affairs and ownership has the benefit of allowing those with obligations under anti money laundering legislation to acquire at least some of the client information that they are required to obtain. The statutory emphasis on accounting matters also has the indirect result that, in the great majority of cases, even very small companies will engage a qualified accountant to keep their books and prepare their accounts. These measures counterbalance, in part, the substantial protection from personal liability that UK company directors enjoy.

2. The US

THE SMALL BUSINESS ENVIRONMENT IN THE US

According to the US Office of Advocacy, in 2009 there were a total of 27.5m businesses in the US, of all legal types. Of these only 0.1% were classed as 'large' (having over 500 employees). Of the remainder, 21.7m had no employees at all, making them by far the largest single category of business. Despite the apparent keenness on the part of many in the SME community to operate as employee-free businesses, 'small' firms (defined in the US as those with up to 500 employees) were collectively responsible for generating 65% of the net new jobs created between 1993 and 2009.

Following the economic downturn in 2008, initiatives to provide support and impetus for small businesses have become increasingly the focus of federal policy. There is a particular focus on increasing exports of American products and services by small businesses, and there is also a distinct federal and state emphasis on assisting women, military veterans, and ethnic minorities to establish small businesses.

The entrepreneurial spirit, incorporating the 'can do' mentality, an aversion to regulation and an indulgent, debtor-friendly attitude towards bankruptcy, is widely considered to be an integral element of American business culture. In the words of President Barack Obama (2011) when launching Startup America, a federal initiative to improve business practices and access to finance for small businesses:

> Small businesses embody the promise of America: that if you have a good idea and are willing to work hard enough, you can succeed in our country.

According to the World Bank's index, *Doing Business 2013*, the US ranks fourth out of 185 countries for the ease of doing business there.

CORPORATE FORMATS FOR SMES

The corporate environment in the US differs in some material respects from that of the UK. Public policy in the US has traditionally tended to focus on the regulation only of large and publicly traded companies, via state and federal laws relating to public corporations. SMEs have tended to trade on an unincorporated basis whereby the owners of the business enjoy full access to the firm's profits but also personal responsibility for its debts and losses. As a consequence of this, the statutory regulation of the SME sector has traditionally been much less extensive than its UK counterpart. The regulation of smaller companies in the US is not, however, as 'light touch' as is sometimes thought, and state laws governing such companies incorporate a number of important stakeholder protection measures.

Businesses in the US that wish to adopt limited liability today have four principal choices: the corporation, the limited liability corporation (the LLC), the limited partnership and the limited liability partnership. States have their own legislation on the regulation of these business forms but all follow a similar pattern: in the case of corporations, for example, states tend to follow the Model Business Corporations Act produced by the American Bar Association.

The most popular form of incorporation for trading SMEs is the LLC. This is a relatively recent innovation, and a response to the fact that the law on corporations has always focused on large/publicly-owned firms and imposes significant levels of compliance obligations on them. Thus small firms now have a means of conducting business via a vehicle which, at least theoretically, offers their owners protection from their company's debts. (Some commentators are sceptical as to whether this protection really exists, given that providers of credit will often insist on making loans directly to the entrepreneurs themselves, imposing higher interest rates to pay for increased risk, and granting smaller loans than they might do otherwise (Berkowitz and White 2004).) The fact that the popularity of the LLC has grown rapidly in recent years suggests, however, that the attraction of the format is real for many entrepreneurs.

The first LLC was legislated for in Wyoming in 1977 but became so popular that all states of the Union now have their own laws to allow the incorporation of LLCs. A 'model law' on LLCs, prepared by the American Bar Association, is available for any state to follow – the Revised Uniform LLC Act of 2006 – but the situation is competitive, to the extent that state laws often differ in various technical respects, including with respect to the ability to transfer individual LLCs from one state to another. The fact that corporate law in the US is organised on a state basis means that it is not possible to present a uniform picture of the characteristics of the LLC across the country, although there are sufficient similarities in key aspects to warrant a generalisation for the purposes of this report.

The LLC is broadly comparable to the UK private limited company, although while UK company law is still very largely integrated, in the sense that public and private companies are essentially the same form of legal animal, LLCs and corporations are considered to be quite different legal forms, and are governed by different company and tax law.

An LLC is created by fulfilling the registration formalities of the relevant state, which will invariably include the payment of registration fees. An LLC is required to file a certificate of organisation, sometimes referred to as articles of organisation, which will cover only basic details about the new company, usually its name and address. The certificate does not generally have to set out the names and addresses of the members, although some state laws require LLCs to provide the names and addresses of the persons who will be their first managers (the equivalent of directors in the UK and elsewhere): if the managers are to be the members, this will mean that the details of the members will be disclosed. Most states also levy an incorporation tax, which, in the original LLC state, Wyoming, is levied in proportion to the amount of capital with which the company is registered: the rate as of 2012 was US$100 for companies with capital of less than US$50,000, then an extra US$100 for the next band of US$50,000 and so on. An LLC must have a registered office based in its state of incorporation, and a 'registered agent', on whom legal documents can be served.

1. Characteristics of the LLC

Notwithstanding the fact that state laws may differ in certain respects, the standard features of the LLC are as follows.

- It is a legal entity separate from its members and enjoys separate legal personality.
- Neither members nor managers are personally liable for the debts of the LLC.
- An LLC can be formed with just one member, and there is no maximum number.
- Managers owe a fiduciary duty of loyalty and care to the company and its members.
- The members do not have to be individuals – they can be other corporate bodies, partnerships or trusts.
- The LLC can buy, hold and sell property in its own name.
- It does not issue shares as such, but members contribute capital (in the form of cash or other property), which may be quantified into membership interests or units.
- The internal governance and management structure is determined by the members and set out in an Organisation Agreement, akin to the traditional partnership agreement – the default rule is usually that the affairs of the company are to be managed by its members, with powers in proportion to their individual capital contributions, but if they wish they can decide by internal agreement to appoint external managers, who will be subject to annual re-election unless otherwise agreed. This document is private and does not have to be published.
- The LLC may or may not have a finite duration – some states provide that the LLC is to be dissolved on the death or resignation of any of its members.
- Neither the members nor the managers (if different) are, in principle, liable for the LLC's debts.

The default rule as regards taxation is that LLCs are taxed on a 'pass through', or transparent, basis in the same way as sole traders or partnerships (though any LLC can elect to be taxed on a corporate basis). In 2003, 67.3% of LLCs were owner-managed and thus taxable as sole proprietorships (Hope et al. 2011). Accordingly, unless the corporate election is made, LLCs do not themselves pay taxes on their corporate profits, and each of their members pays tax on his or her own earnings from the business. Where the LLC has only one member, the Internal Revenue Service (IRS) requires that member to report all the LLC's profits or losses to it with his or her tax return. Where there are multiple members, each member must pay taxes on his or her share of the profits from the company, such share being calculated, for tax purposes, as if the member had received all the designated share (or 'distributive share') of profits as determined in the LLC's Organisation Agreement. This applies even if the company decides to retain profits in any year and not to distribute the whole amount to its members – the members pay income tax on all profits made during that year, whether or not they receive their shares of them.

Each year, the LLC must still, however, file a return, IRS form 1065, which supplies the IRS with information on the determination of the firm's profit for the year. Form 1065 is a pro forma that requires firms to report prescribed information, including gross sales, cost of goods sold and gross profit. Firms are generally entitled to assemble their financial information on a cash or accruals basis: although accrual accounting is required where firms produce, purchase or sell merchandise, generous exemptions apply where the taxpayers' income is below stated levels. The IRS reviews form 1065 to ensure that profits are 'correctly' reported and, subsequently, to ensure that individual members are paying the tax they should pay on the basis of their distributive shares of the company's profits.

Substantial penalties may be imposed if an LLC, or other form of enterprise, fails to comply with the requirements to file a correct return. A monthly penalty may be imposed on the firm, and further penalties may be imposed where the firm fails to issue the necessary personal statements to its members. As of 2012, penalties in these circumstances are able to reach US$1.5m in the calendar year.

In addition to the above, some individual states levy additional tax or fees on the LLC, but these may be unrelated to the firm's income.

2. Public accountability

Compared with companies in the UK, LLCs are subject to many fewer public accountability requirements. Most states require LLCs in their jurisdiction, on incorporation, to file with the state authorities basic details about themselves and to file any later amendments to that information. Most states require LLCs to submit a document called the annual return – some states, including Wyoming, require this to include, inter alia, financial information on the LLC's capital, property and assets, to be made out on the same pro forma basis as is used for providing information to the IRS, and which is used by the state for the purposes of determining the LLC's annual 'license fee'. Some states record on publicly searchable databases the fact that companies have complied with their filing requirements although they will not normally make available the information received. Where this is the case, third parties can thus obtain access to very basic information as to the contact details of companies and whether they are in good standing in respect of their fees and taxes. Wyoming (among other states) also offers to provide third parties with a separate 'certificate of existence', which brings together this information in a stand-alone document.

LLCs are required to include the words 'limited liability company' or an acceptable abbreviation in their corporate name; failure to make clear their status when dealing with third parties may lead to piercing of the 'corporate veil' and the loss of limited liability for its members.

There is no default statutory requirement for LLCs, regardless of size or number of members, to prepare and publish financial statements or any other information on their activities or financial position. It follows that there is no requirement for the accounts of LLCs to be audited, regardless of size. In respect of accounting and tax, the position of the LLC is akin to that of the traditional partnership, to the extent that the financial affairs of the business are considered to be the domain of those running the business. This is despite the obvious difference in that partners in a partnership will invariably be personally liable for the debts of their partnership while the managers and members of an LLC will not be.

Other than through the procedures for regulating the LLC's tax affairs, the state therefore assumes a comparatively low-key regulatory role in obligating the efficient financial management of individual LLCs and in providing third parties with up-to-date information about their performance or financial health. While, in Wyoming, there are requirements for books and records to be kept and retained for a set period, this requirement is expressly linked to the significance of books and records for calculating the LLC's annual 'license fee' to the state.

3. Additional legal measures to protect stakeholder interests

To compensate for the comparative absence of public accountability requirements, LLC statutes provide certain protections for the interests of members and third parties.

- An LLC may distribute profits among its members only if specified conditions are met. The Uniform Act provides that a distribution may not be made if, after the distribution is made, the company would not be able to pay its debts as they fall due, or if the company's total assets would be less than the sum of its liabilities plus the amount that would be needed, should the company have to be wound up, to pay those creditors who would have preferential rights superior to those of the members receiving the distribution. Thus any decision to distribute profit needs to be taken on the strength of a cash flow calculation as well as a balance sheet calculation, taking into account the known claims of the company's creditors. In keeping with the disinclination of LLC law to interfere with accounting matters, there are no specific rules as to how profits and losses are to be determined, but the Uniform Act says that the company 'may' base its determination as to whether a distribution is lawful on financial statements prepared on the basis of accounting practices and principles that are reasonable in the circumstances (or on a fair valuation or other method that is reasonable in the circumstances). (NB the only high-level technical standards in application for the preparation of financial statements have been those that make up UK GAAP, as issued by the Financial Accounting Standards Board (FASB). Following a long investigation into the suitability of UK GAAP for non-publicly traded companies, a new structure has, however, been agreed whereby individual standards are reviewed for proportional application to private companies, with a view to their amendment for that constituency. In a related but separate development, the American Institute of Certified Public Accountants (AICPA) has announced (2012) an additional initiative to prepare a non-GAAP financial reporting framework for privately held small and medium-sized entities that do not need US GAAP financial statements.)

- Where an LLC makes an unlawful distribution, a member who has consented to the approval of the distribution and in so doing fails to act in accordance with his or her statutory duty of care will be personally liable to repay to the company the difference between what was paid out and what could lawfully have been paid out. Members receiving the distribution will also be liable to repay the same amount to the company if they knew it was unlawful.

- Members have rights to inspect the company's books and records.

- The LLC, through its managers, is required to provide to members – without demand – information concerning the company's activities and financial condition that the company has and that is material to members' rights and duties under the Operating Agreement. It is also obliged to provide to members other information about the company and its financial condition on demand.

- Members are liable to their LLC in respect of whatever amounts may be outstanding on their promised contributions to the company's capital.

- When statutory records that are filed with the state contain inaccurate information, any person who suffers loss by relying on that information may recover damages from any person who signed the record and knew the information was inaccurate at the time it was filed.

It follows from the above that there is an implication that LLCs will need to maintain financial records and prepare proper accounts for business purposes (rather than regulatory purposes). The main differences between US and UK law in this respect are as follows:

1. Accounting information tends to be seen in the US in a more restricted sense as a basis for members and the tax authorities to make their own decisions about the company.

2. US law does not mandate the production of general-purpose financial statements and for this reason does not mandate either the form or the content of accounts prepared on a voluntary basis.

3. There is no provision in the law for companies to make financial information generally available to third parties.

There is no separate code of rules in US bankruptcy law for dealing with LLCs. Insolvent LLCs are therefore subject to the federal Bankruptcy Code and, subject to the comments below, may enter formal procedures to liquidate or reorganise the business, either voluntarily or involuntarily. US bankruptcy laws are heavily slanted towards providing opportunities for entrepreneurs to make a fresh start after accumulating burdensome debts. A landmark 1934 legal judgment stressed that the purpose of bankruptcy is 'to give to the honest but unfortunate debtor a new opportunity in life and a clear field for future efforts unhampered by the pressures and discouragement of pre-existing debts' (Local Loan Co. v Hunt, 54 S.Ct. 695, 1934). In keeping with this philosophy, most bankruptcy debts are dischargeable and individual debtors tend to obtain their discharge within a few months.

When an LLC becomes insolvent and enters into the standard liquidation procedure, creditors' rights will generally be classified as either secured claims, priority unsecured claims (these include employee wage and benefit claims and debts incurred by the firm between the filing of a creditor petition and the granting of the bankruptcy order), and general unsecured claims (which have lowest priority). Under federal law, trade creditors enjoy a special privilege in that unpaid invoices issued in the 20 days preceding the entry into bankruptcy are regarded as being administrative expenses and should thus be repaid as of priority by the trustee (although where no assets are available to the trustee, creditors are not likely to receive anything).

Members of an insolvent LLC will technically owe no obligations in insolvency because of their limited personal liability. As outlined above, however, LLC managers and members may be required to repay monies that have been distributed illegally. The US criminal code also contains a number of offences on concealment of assets and embezzlement, which are punishable by fines or imprisonment. It should, however, be noted that there is a lack of certainty in the LLC regulatory framework as regards how the corporate character of the LLC is to be accommodated in insolvency. The courts will normally treat an LLC like a corporation, but where it is owned by one individual – as is the case with the majority of LLCs – they can treat the LLC bankruptcy as a sole proprietorship bankruptcy, depending on the merits of the case. When the corporate veil is pierced in this way by the bankruptcy courts, the assets of the business owner may be treated as business assets, sold and the proceeds used to pay off the creditors.

4. Business relevance of accounting and auditing at the SME level

As already noted, while LLCs are not required to prepare and publish financial statements by law, they are obliged to prepare accounting information for submission to the IRS (this forms the basis for the determination of individual members' tax liability) and are entitled to make distribution decisions on the basis of properly prepared financial statements. They are also obliged to keep their members informed of the financial condition of the company. In all these cases the engagement of an external accountant is likely to be seen as standard practice and necessary.

Irrespective of the absence of statutory requirements for LLCs to prepare and publish financial statements, there is still a widespread recognition in the business community of the importance of preparing quality accounts for the purposes of effectively managing the firm, for avoiding problems with the tax authorities and for establishing the firm's credentials in relations with providers of finance and prospective customers and suppliers. There has also been a considerable amount of research attention in the US into the use made of annual accounts at the SME level.

As elsewhere, SMEs are to a great extent dependent on securing external finance to fund starting up, working capital and growth. Traditionally, commercial banks have been the leading supplier of debt capital to small firms in the US (Ou 2006), and despite the fall-out from the banking crisis this seems to be still largely the case, even if small firms obtain credit from an increasingly wide range of sources, including credit unions, business and personal credit cards, trade credit and thrift unions. Small businesses rely heavily upon both owner investment and bank credit, averaging about US$80,000 a year for young firms, which receive about three-quarters of their funds from banks through loans, credit cards and lines of credit (Kauffman Foundation 2010).

The importance of providing credible financial information to support the applicant's creditworthiness will invariably be a factor in determining the success or otherwise of any application for finance. Support from the Small Business Administration (SBA) is dependent on the submission of a substantial quantity of paperwork on the part of the applicant: this will routinely include a retrospective profit and loss statement, made up to a date within 90 days of the application, as well as projected financial statements.

It has been argued that more small firms in the US would be able to obtain credit if they were to position themselves as being appealing to creditors (Cole 2010). A study by Allee and Yohn in 2007 also shows that firms that are able to provide audited financial statements are significantly more likely to obtain credit than those that cannot, and that when credit is obtained, it will be on more beneficial terms to the borrower. (The same authors also claim that LLCs are the most likely form of SME in the US to produce and use financial reports for business purposes.)

Whether for statutory or other reasons, the importance for achieving effective business management of engaging an external accountant is as widely recognised in the US as it is elsewhere. Jerry Gordon, president and chief executive of the Fairfax County Economic Development Agency, a renowned hub of entrepreneurialism and business success in Virginia, has said that for all business entity types, 'it is very, very, very important – in fact it is the first thing we advise – that new businesses employ both a qualified accountant and a qualified lawyer'.

SUMMARY

The laws governing limited liability companies in the US do not mandate the preparation and publication of annual financial statements on a standardised basis, as is the case in the UK, other EU countries and elsewhere. It follows that there is no expectation that the accounts of LLCs, where they are prepared, should be subjected to independent audit.

There is no standard requirement for small companies to produce general-purpose financial statements, no legal requirements as to the standards that should be applied to such statements where they are prepared, and no general requirement for this or other financial information to be placed on the public record. There is no acknowledgement in the law that LLCs should publicly disclose information on their financial affairs as a quid pro quo for acquiring limited liability, that third parties might benefit from being able to access information on companies routinely, to protect their interests, or that disclosure might actually facilitate trade. There is thus a strong emphasis on information privacy, in line with traditional rules governing unincorporated partnerships, and it is not considered appropriate for the law to intervene in these areas, which are seen as best left to direct investors and the market.

It would be wrong, however, to conclude that US laws are unmindful of the importance of keeping accurate records and preparing credible accounting information. LLCs have to provide detailed financial information for the IRS, they are bound to make decisions on distributable profits on the basis of accounting information, and they are obliged to keep their members informed of their financial condition. Over and above statutory provisions, it appears that professionally prepared financial statements, both historic and prospective, are widely seen as adding credibility to any small business when dealing with third parties, especially lenders of finance.

There are also elements in the US framework that impose burdens on LLC members and managers that are over and above those of the corresponding framework in the UK. These conceivably make up, at least in part, for the lack of stakeholder protection represented by the lack of regulation on financial matters. In keeping with the partnership antecedents of the LLC, personal liability is incurred by managers who approve unlawful distributions or who allow inaccurate information to be filed with state authorities (where third parties rely on it and thereby suffer loss). The tax authorities have substantial powers to penalise both LLCs and their individual members in cases of non-compliance with the tax rules, and under federal bankruptcy laws trade creditors have priority rights in respect of bankruptcy debts incurred within 20 days of the bankruptcy. The corporate veil may also be pierced in the case of single-member LLCs when they enter into formal insolvency procedures, with the result that owners effectively assume personal liability for their company's debts.

Accordingly, while the regulation of LLCs is generally of a 'light touch' nature, the corporate nature of the LLC is less clear cut than in other countries and owners and managers assume a significant risk of personal responsibility for the actions of their company, which to an extent reduces the policy case for imposing rules on accounting and disclosure.

3. Australia

THE SMALL BUSINESS ENVIRONMENT IN AUSTRALIA

The Australian economy was not as badly affected by the global banking crisis of 2007–8, and its aftermath, as Europe and North America have been. The country was one of only two OECD economies that did not experience a recession in the late 2000s. Australian unemployment has thus remained relatively low, and Australia's raw materials and exports have produced a dynamic and forward-looking business culture and substantial economic and demographic growth. At just over 22m, the country's population is small but highly educated, young, and largely urban. Substantially larger in size than Europe, but with less than one-thirtieth of its population, Australia has plentiful raw materials, in particular iron ore and coal, hence sectors such as mining (exporting principally to China), agriculture and construction have been significant economic drivers over recent decades.

As of June 2011 there were 2,132,000 businesses trading actively in Australia. There is no special definition of small business in the Corporations Act or the ASIC Act, but the Australian Bureau of Statistics (ABS) defines a micro business as one with 0–4 employees, a small business as one with 5–19 employees, a medium-sized business as one with 20–199 employees and a large business as one with 200 or more employees. On this basis, of the 2.1m businesses in existence in 2011, 95.6% were small or micro businesses, 4% were medium-sized and fewer than 1% were large (Department of Innovation, Industry, Science and Research 2011).

Small businesses were responsible for 47.2% of total industry employment, even though 60% of all businesses covered by the study employed no staff at all (ie were micro businesses). Employer micro businesses made up the next largest segment of businesses (24% of the total), followed by employer small businesses (11%) and medium-sized businesses (4%). Thus, micro and small businesses employing staff together account for around 35% of all businesses in Australia. In 2008/9, micro businesses, both employing and non-employing, accounted for 93.5% of all business entries and 92.6% of exits. Of the total business population, the great majority, 39%, were sole proprietorships, 26% were 'proprietary limited companies' and fewer than 1% were corporations.

The Australian federal government is very conscious of the importance of the SME sector for the national economy. Senator Nick Sherry, the former Australian Minister for Small Business, has described small businesses as the 'engine room of the Australian economy', and recent reforms to the company law regime have followed similar lines to the reforms undertaken in the UK, with an emphasis on deregulating compliance obligations for smaller businesses and the introduction of a Standard Business Reporting initiative, which has streamlined business-to-government financial reporting.

Although Australia has a federal government structure, policy and practice variation between states and territories in Australia on business issues appears to be small and there is little in the way of competition between the regimes of the different states. The Small Business Development Corporation of Western Australia has suggested that:

> although legislation and payroll tax may differ slightly between states and territories, there are no states that have a legislative structure that greatly benefits small businesses when compared to other states.

Australia ranked tenth in the world for ease of doing business in the World Bank's index *Doing Business 2013*.

CORPORATE FORMATS FOR SMES

Although Australian company law derives substantially from its UK equivalent, and accordingly many of the principles that apply in the two countries are similar, Australia has proved dynamic and innovative in exploring new solutions on a range of issues, including the SME sector.

Company law in Australia is organised on the federal level via the Corporations Act 2001. For those small and medium-sized businesses that wish to incorporate and adopt limited liability status, the standard choice is the 'limited' version of the proprietary company (PC), which is distinct from the 'public company' (PCs can also operate in unlimited form). As of June 2012, there were 1,921,000 companies in Australia, of which only about 31,000 were public companies (Senate Standing Committee on Economics 2012).

A PC can be formed with only one member/shareholder and must not have more than 50 non-employee shareholders. The company is formed by lodging prescribed forms and information with the Australian Securities and Investment Commission (ASIC); this information will include the name and address of each person who consents to becoming a member, the name and address of each person who is to be a director or company secretary of the company, the address of the company's registered office and principal place of business, and detailed information about the initial shareholdings. There is no requirement for a PC to file its constitution with the ASIC, or even have one, although many appear to have them.

The key organisational characteristics of the 'limited' version of the PC are as follows.

- It has legal personality.
- It has perpetual succession until dissolution.
- Its members are not personally responsible for the company's debts beyond the amount, if any, that remains unpaid on the shares that they have agreed to take.
- Its members may transfer their shareholdings if they wish.
- It may charge its assets as collateral for credit.
- Its affairs are managed by its directors, of which there must be at least one.
- The company is taxed on its corporate profits.

The features of the PC are thus more akin to those of the UK private company than the US LLC.

Companies pay an annual 'review fee' to ASIC (A$230 as of July 2012).

PUBLIC ACCOUNTABILITY

For each financial year, public companies and 'large' PCs are required by the Corporations Act to prepare a financial report and a directors' report, and to file those reports with the ASIC. The financial report contains financial statements (to be prepared in accordance with IFRS in the case of listed companies and Australian GAAP otherwise), notes to those statements and a directors' declaration, which includes a solvency declaration that states that, in their opinion, there are reasonable grounds to believe that the company will be able to pay its debts as and when they become due and payable, and the financial statements and the notes are in accordance with the Corporations Act. The report needs to be audited by an independent auditor.

PCs that are classed as 'small' are exempt from these requirements. A PC meets the test if it satisfies at least two of the following (2012 figures).

- The consolidated revenue for the financial year of the company and the entities it controls (if any) is less than A$25m.
- 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 A$12.5m.
- The company and the entities it controls (if any) have fewer than 50 employees at the end of the financial year.

Significantly, however, any small PC that does not prepare a financial report must pass a resolution of solvency within two months of its 'review date' (the anniversary of its incorporation, when each company is invited to confirm details held on it by ASIC). The resolution must confirm that there are no grounds to believe that it will not be able to pay its debts as they fall due. Where the directors do not feel able to make this positive statement, they must file a statutory 'statement in relation to company insolvency' with ASIC by a set deadline. A positive resolution of solvency by a company need not be filed, but the fact that the 'review fee' has been paid by a company is taken to imply that the directors have made a positive declaration of their solvency and third parties are entitled to make this inference.

The law further addresses the information needs of shareholders by providing that a small PC will still be required to prepare a financial report if it is directed to do so either by shareholders holding at least 5% of the voting rights in the company or by ASIC (if it suspects that malpractice or fraud is taking place). The shareholders, in giving their direction that a financial report should be prepared, may decide that the company need not comply with the requirements of Australian GAAP, that a directors report need not be prepared, or that the financial report needs to be audited (PCs limited by guarantee can call additionally for the accounts to be 'reviewed' rather than audited). The direction from shareholders or the ASIC will be only to prepare the report – it does not mean that the report should be filed and made available on the public record (although the ASIC, when it issues a direction, may require this to be done).

Whether or not a company is subject to a legal requirement to prepare and publish an annual financial report, it is subject to the following compliance requirements.

- It must display its name at all its business premises and display both the name and its registration number (ACN) on specified documents.
- It must keep written records of its financial transactions sufficient to enable the company to prepare true and fair accounts.
- It must keep a register of shareholders.
- It must confirm with ASIC prescribed details of its directors and shareholders and its places of business each year via the 'annual statement'.
- It must keep a register of charges.
- It must notify ASIC of any prescribed events, including share issues, changes in directors or a change in the address of its registered office.
- It is required by the tax authorities to keep detailed records of specified business transactions and capital gains for five years.

ASIC maintains an online database on all Australian companies and this enables any party to access the details of all companies on the central register. Where companies have filed a financial report, this will be available to inspect. In respect of small PCs that have not filed a financial report, searchers can still access details of those companies' directors, share structure and charges.

ADDITIONAL LEGAL MEASURES TO PROTECT STAKEHOLDERS' INTERESTS

The interests of shareholders and creditors are also served by a number of significant provisions in the Corporations Act.

- Companies may pay dividends only if their assets exceed their liabilities (to be calculated in accordance with Australian GAAP); if the proposed dividend is fair and reasonable to the shareholders as a whole; and if the payment does not materially prejudice the company's ability to pay its creditors.
- Directors are subject to statutory duties, including a duty of care and diligence. They may be personally liable to compensate the company or others for any loss or damage they suffer as a result of their failure to comply with their duties. They also commit a criminal offence if they fraudulently induce parties to give credit to their company or if they defraud their own company.
- Directors are required to protect the interests of creditors by not trading while insolvent. Specifically, this means that they may not incur debts when their company is insolvent, or allow their company to become insolvent by incurring that debt. The latter applies, for example, when the company pays a dividend and the company becomes insolvent as a result. Directors who infringe this rule are subject to civil and criminal penalties. Holding companies are additionally liable for the debts of their subsidiaries if the parent has permitted the subsidiary to trade while insolvent.
- Directors who fail to comply with their statutory duties, not only in respect of financial reports but also in numerous other cases, may incur civil penalties of up to 2,000 penalty units (units subsequently convert to financial amounts) or up to five years' imprisonment, or both. The courts will take into account whether a particular contravention has materially prejudiced the interests of the company or its members or has materially prejudiced the company's ability to pay its creditors.
- Directors may be disqualified from holding office for breaching their duties.
- Shareholders may apply to the courts to intervene if they consider that the company's affairs are being conducted in a way that is unfair either to shareholders or the company itself.
- While it appears to happen rarely in practice, the law allows individual creditors of a company in liquidation to seek permission to take their own direct action to recover debts owed to them, ie without waiting for the liquidator to act on their behalf.

TAXATION

In keeping with the separate corporate personality of the company, Australian PCs are taxed on their corporate profits, as is the case in the UK. PCs are required to complete and file with the Australian Tax Office (ATO) the pro forma company tax return for each tax year. They are, however, entitled to calculate their figures on a cash or accruals basis.

The Australian framework makes it very clear that a company's directors are ultimately responsible for ensuring that its tax debts are paid. Until 1993, the ATO held priority rights in liquidation in respect of unpaid corporate tax. This right was withdrawn as of that date, in order to improve the position of trade creditors, but at the same time the ATO was granted enhanced rights to pursue directors personally for the unpaid taxes. The right to pursue directors personally may be claimed irrespective of whether a company is in liquidation.

The ATO may issue a Director Penalty Notice (DPN) under the Income Tax Assessment Act 1997 (ITAA) to a company's directors at any time if the company has failed to remit tax. This notice instructs the company's directors to act within a set deadline to cause the company to take one of four stipulated actions. These actions are:

- pay the liability or estimated liability as indicated in the notice, or
- enter into a repayment agreement with the ATO in respect to the liability or estimated liability, or
- appoint an Administrator to the company (pursuant to the Corporations Act), or
- wind up the company.

If the company served with such a notice does nothing, the ATO may recover the tax liability or estimated liability from each company director on a joint and several basis. Directors who have resigned may also be liable if any portion of the debt arose and was unpaid during their directorship. Recently appointed directors may also be responsible for debts incurred before their appointment if, during their period of appointment, there were unremitted tax debts.

In addition to the above, strict new rules under the Pay as You Go Withholding Non Compliance Tax Act 2012 specifically extend personal liability to directors where their company fails to make returns or pay PAYG tax or superannuation amounts within three months of their falling due. Where the return has been filed but the tax has not been paid, the ATO must issue a DPN, thereby giving the company the options referred to above. Where neither the return nor the tax has been submitted within the three months allowed, liability becomes automatic.

BUSINESS RELEVANCE OF ACCOUNTING AND AUDITING AT THE SME LEVEL

As already stated, PCs that qualify as small, ie the great majority of them, are not obliged to prepare annual financial statements; even when they are required to do so by their shareholders, such accounts may not have to follow the requirements of Australian GAAP. Thus, as is the case in the US, the Australian company law regime does not see the preparation and publication of standard-form general-purpose financial statements as being in itself a necessary element of the regulatory framework for protecting stakeholder, especially creditor, interests. Creditors and prospective business partners thus do not routinely have access to publicly available and up-to-date financial information about the affairs of small PCs.

Given the demands of the tax system and the significant consequences for companies and their directors of failing to observe the sometimes stringent requirements of the Corporations Act, especially in relation to the payment of dividends, it seems probable that, in practice, even small PCs make extensive use of the services of external accountants for compliance purposes, as well as for traditional ancillary purposes such as helping with the process of accessing external finance. The Australian government and other agencies actively promote the use of accountancy professionals by small firms (ASIC advises small companies that they 'may' need to produce financial reports for managing their own business performance and to satisfy the requirements of lenders, the tax authorities and others). Senator Nick Sherry has commented, 'accountants and tax agents fill a very important role in providing sound advice to small businesses', and observed that:

> accountants are important for a range of matters, such as financial reporting, helping small businesses understand how to measure and report on profitability and ensuring adequate cash flow monitoring to prevent viable businesses going under unnecessarily.

One legal academic who contributed to the preparation of this report suggested that:

> a large proportion of companies may be still preparing financial accounts because doing so will be helpful for tax purposes, for obtaining loans or just as a matter of good business practice to monitor and better manage the business.

Mike Dixon, a former chair of *ACCA Australia and New Zealand*, suggested a number of specific factors that would encourage small businesses to engage qualified accounting advice:

- the requirement to lodge monthly or quarterly business activity statements with the Australian Taxation Office (these returns record GST/PAYG withholding and PAYG instalments), which effectively requires relevant PCs to maintain periodic management accounts to support this
- banking covenant requirements for bank lending purposes that a PC provides regular management accounts, which are sometimes required to be audited
- the requirements for owners and stakeholders to satisfy themselves that the PC is in sound financial shape from a corporate governance perspective.

SUMMARY

The Australian regime for PCs combines elements of both the UK private company and the US LLC. Like its UK counterpart, the PC forms part of a wider, integrated company law framework, which accommodates derivations and exemptions intended to strike a more proportionate cost-benefit balance for smaller businesses. As with the framework for LLCs, there is official acceptance that small companies should be entitled to decide for themselves how they organise their accounting and audit.

Although there are requirements for all PCs to file prescribed information about themselves with ASIC, and although any third party is able to access that information via the central ASIC database, there is no standard requirement for 'small' PCs, as defined by reference to financial criteria, to publish or even prepare annual general-purpose financial statements. Thus, as is the case in the US, the regulatory framework for the smallest companies does not see the public availability of this information as a safeguard that should be provided for by law in order to protect third-party interests or to facilitate trade at this level.

The absence of a mandatory disclosure regime is, however, offset by a number of meaningful protections for minority shareholders and creditors. Most importantly, shareholders, even those holding only 5% of the voting rights, may insist that a financial report be prepared. Where shareholders do not call for this to be done, the company's directors are required each year to prepare a declaration of solvency, and where they cannot make a positive declaration they must file a statement to that effect with the authorities. This acts effectively as an alternative source of assurance for third parties as regards the health of the company and the wisdom of trading with it. Directors are liable to compensate their company for any losses that it incurs as a result of their failure to act in accordance with their responsibilities. The law also imposes explicit requirements for directors to take into account the interests of both shareholders and creditors in making dividend decisions and threatens them with personal liability if they trade or withhold taxes while insolvent. The interests of creditors are further served by the provision that allows holding companies to be made liable for allowing their subsidiary companies to trade while insolvent.

The significant consequences for directors of failure to comply with the above provisions amount to indirect incentives for even small PCs to ensure that they record and calculate properly all financial information about their affairs and transactions and are able to assemble it in credible form for decision-making purposes.

4. Singapore

THE SMALL BUSINESS ENVIRONMENT IN SINGAPORE

Singapore offers a highly pro-entrepreneurial environment with one of the most business-friendly economies in the world. As with other free market economies such as the US, there is a powerful business culture which promotes the idea of the small entrepreneur as a generator of wealth. Given that Singapore is very small, both geographically and demographically, there is a strong government focus on encouraging Singaporean SMEs to export overseas, and export markets provide one of the most significant sectors in the Singaporean economy. This focus on exports left Singapore vulnerable to a collapse in export demand from the West following economic problems there, and so Singapore went into recession in late 2008 and, despite recovery since then, growth in 2012 was estimated to be only 1.2%. Despite this, the territory remains one of the world's strongest economies. The attractive corporate tax rates – between 9% and 17% depending on profit size – reinforce the official encouragement of business activity.

Since 1 April 2011 the Singapore Ministry of Trade and Industry has defined an SME as an entity which:

- has annual sales turnover of not more than S$100m, or
- employs no more than 200 staff.

Using this definition, there were just over 154,000 SMEs in Singapore in 2011, constituting over 99% of all Singaporean enterprises. The proportion of SMEs of the total number of enterprises has remained constant at this level over the past decade. SMEs' value-added contribution to the Singaporean economy increased steadily from 46% in 2003 to 49% in 2007, and they have consistently employed in excess of 60% of the Singaporean work force. Manufacturing SMEs, while comprising only 5% of the total number of SMEs, generated 17% of SMEs' total value added (Singapore Department of Statistics 2009).

The new challenges facing the SME sector in the wake of the global financial crisis and developing regional competition in South East Asia have prompted the government, in 2012, to take additional measures designed to improve SMEs' access to money and markets and to strengthen their ability to survive and prosper. This has followed concerns raised by many SMEs in Singapore about rising business costs and curbs on the recruitment of foreign labour. A review of the SME sector initiated in April 2012, which was to be undertaken by the government's Standards, Productivity and Innovation Board (SPRING) and International Enterprise Singapore, was given the remit to consult with members of the business community about the measures that they think the government could consider to strengthen the sector and improve its performance in specific areas, such as innovation, branding and entry into overseas markets. The Minister for Trade and Industry, Teo Ser Luck, in a speech to SME business leaders in August 2012 about the government's review, said 'in the years ahead and many beyond, SMEs will continue to be the backbone and the lifeblood of our economy, and we expect their importance to grow'.

As of 2012, in a separate initiative, the government is conducting an extensive review of Singapore's company law framework, along the lines of the reviews that have already taken place in the UK and Australia. This exercise is, in part, addressing the question of whether the regime imposes proportionate burdens on SMEs that are limited companies.

In the World Bank's index, *Doing Business 2013*, Singapore is ranked No 1 in the world for ease of doing business.

CORPORATE FORMATS FOR SMES

Incorporation of businesses is officially encouraged in Singapore since it is often a precondition of gaining access to government grants and incentive schemes.

There have been several significant developments in recent years to extend the options for businesses seeking limited liability in Singapore. In 2004, it became possible to form a company with just one member. Later in the decade, the limited liability partnership (LLP) and the limited partnership (LP) were introduced. Via these formats, businesses may arrange their affairs so that a measure of limited liability applies in respect of the debts of the firm, although in neither case is the limitation of liability absolute.

Another important change was introduced in 2003 to the longer-standing private company format. The regular private company is one that has no more than 50 shareholders and that, via its constitution, restricts the rights of members to transfer their shares. A new 'class' of private company, called the Exempt Private Company (EPC), is one with no more than 20 shareholders and in which no other company holds a direct or indirect interest. Since 2003 the EPC has become the most popular business format, making up 43% of all businesses in 2011 (as opposed to sole proprietorships at 36% and 'other' private companies at 8%). Following the introduction of the EPC in 2003, many SMEs either became EPCs automatically, because of their ownership structure, or incorporated as private companies in order to be able to take advantage of the derogations that are available via the new format (as outlined below). These derogations include ad hoc measures such as greater freedom to make loans to the company's directors, but the most important element in the EPC package is that it has, for the first time, allowed small companies to claim exemption from the hitherto uniform requirement to file audited accounts on the public record.

For the purposes of applying particular statutory rules, the EPC can be further subdivided into the 'small' EPC and the 'normal' EPC. A small EPC has an annual revenue of up to S$5m while a normal EPC's revenue exceeds S$5m.

Features of the private company

A company may be formed by filing prescribed documents, including the memorandum and articles of association, with ACRA (Singapore's Accounting and Corporate Regulatory Authority) and paying a fee. The memorandum must set out basic details about the company: its name, the amount of its share capital and whether the liability of its members is to be limited or unlimited. A company can be private, meaning that it may not offer shares to the public, or public, meaning that it can.

The basic features of the private company are as follows.

- It can be formed with a single member.
- It has legal personality and can sue and be sued in its own name.
- It has perpetual succession.
- It must appoint directors to manage its affairs, at least one of whom must be ordinarily resident in Singapore.
- Its members and directors are not, generally, personally liable for the debts of their company.
- Its directors are subject to a duty to act honestly and to use reasonable diligence in the discharge of their duties.
- It may grant charges over its assets as collateral for credit; where it does it must inform ACRA and keep an internal register of all charges granted.
- It is taxed on the profits it makes as a corporate body.

These features apply to all private companies, whether or not they are EPCs.

PUBLIC ACCOUNTABILITY

There is a strong official view in Singapore that the publication of information by companies about their activities and financial position is and should be the consequence of their acquisition of limited liability status. ACRA says that this is:

> part of the principle of corporate disclosure and transparency that is imposed on a company, which commonly enjoys limited liability. Members of the public, including creditors and other interested parties, must have access to regularly updated shareholder, director and other financial information of the company.

In its consultation paper issued in 2011, the government's steering committee set up to review company law in Singapore said that:

> the starting premise [as regards reporting obligations] is that all companies, by choosing to use the company structure as a business vehicle, should provide disclosure of useful information to members of the public through filing with the Registrar, so as to enable persons who deal with them to make informed decisions.

There is thus a basic public policy belief that limited companies should be required to disclose information about their activities not only for reasons of regulatory supervision but because that information may be of practical benefit to third parties. In keeping with this approach, ACRA provides comprehensive online access to all the corporate information that companies are required to file with it.

The standard rules on public accountability for private companies are as follows.

- Any company that grants charges over its assets must file the associated information with the Registrar; this information is made publicly available.

- All companies are required by law to keep accounting and other records sufficient to explain the transactions and financial position of the company and enable the preparation of annual accounts that meet the legal test of showing a true and fair view.

- Every company must prepare and present to its shareholders annual accounts comprising a profit and loss account/statement of comprehensive income and balance sheet/statement of financial position prepared in accordance with Singapore accounting standards and giving a true and fair view. (Until the end of 2010, all companies were required to comply with full Singapore Financial Reporting Standards (SFRS). From 1 January 2011, SMEs have, however, been allowed to use SFRS for small entities, which is based on IASB's IFRS for SMEs.)

- Every company must file with the Registrar of Companies an annual return containing prescribed information about the company, including a list of charges registered against the company's assets and details of the amounts covered by those charges, details of the company's share capital and information about the company's shareholders. Public companies and private companies (other than EPCs) must attach their audited annual accounts to the return.

Derogations for EPCs

While all EPCs must prepare annual accounts on the standard basis, they are exempt from certain of the related requirements. 'Small' EPCs need not file their accounts with the Registrar or have them audited. 'Normal' EPCs must have their accounts audited, but, again, need not file them on the public record. The popularity of the EPC format among SMEs since it was introduced in 2003 suggests that proprietors of small companies value the opportunity not to file their financial statements on the public record, probably because they see not doing so as a competitive advantage. It has also been suggested, by the government's steering committee on company law, that very many small companies in Singapore will be family-owned companies, which would want to keep private financial information about their business affairs.

Nonetheless, these exemptions are not unconditional. EPCs still need to prepare annual accounts that meet the legal test. Where EPCs do not file their accounts, they must instead make a declaration of solvency via a standard, online form. This declaration states that the directors have formed the opinion that their company will be able to pay its debts in full within a specified period (any director who makes this declaration without having reasonable grounds for doing so commits an offence and is liable to a fine or imprisonment or both). If the directors do not feel able to make the declaration of solvency, they must file their company's accounts.

There are two further safeguards available. In the case of 'small' EPCs, which are otherwise exempt from audit, any member or members of the company who make up at least 5% of the members, or who hold at least 5% of the issued shares, may insist that the company has its accounts audited. The Registrar of Companies may also intervene to require any EPC to file audited accounts if he or she believes that the company is in breach of the legal requirement to maintain proper accounting records or if he or she believes that it would otherwise be in the public interest to take such action.

The annual accounts that companies are required to prepare for company law purposes form the basis for the company's tax computation. Each company is required to file an annual tax return with the tax authorities by a set date each year; its most recent annual accounts, whether audited or unaudited, should be attached to the return.

ADDITIONAL LEGAL MEASURES TO PROTECT STAKEHOLDER INTERESTS

As stated above, a strong element of the public policy objective in Singapore is to make available information that is potentially relevant to the decisions that stakeholders may make regarding their relationships with individual companies. Accordingly, the reporting of accounting information is seen expressly as a device for defending stakeholder interests. Additional safeguards that the law provides for shareholders and creditors include the following.

- Directors have a statutory responsibility to act honestly and with due diligence in carrying out their functions. It is a criminal offence to breach this duty. As well as facing penal consequences, directors who breach this duty are liable to compensate their company for any profit they make and for any damage it suffers as a result.

- Directors may only make dividend payments out of allowable 'profits'. Any director or manager who allows a dividend to be paid in contravention of this rule commits an offence, and also becomes liable to repay the debts of the company's creditors to the extent that the dividend paid out has exceeded the lawful level of distributable profits.

- Directors may be made personally liable for the company's debts and liabilities, without limitation, where it is found, either in the course of liquidation or any legal proceedings against the company, that the company has been conducting business fraudulently or has incurred debt that, at the time, the company had no reasonable or probable expectation of repaying.

A company's directors also commit offences where they, inter alia:

- fail to ensure that their company complies with its obligations regarding the preparation and presentation of annual accounts

- obtain money or property for their company by fraudulent means

- fraudulently induce others to give credit to their company or otherwise trade with intent to defraud creditors

- wilfully make any false or misleading statement in any official document, including those filed with the Registrar.

Company directors may also be disqualified from holding office if they have been convicted of an offence involving fraud or dishonesty or if they have failed repeatedly to comply with their obligations as directors.

Creditors' rights are additionally protected by an extensive insolvency regime set out in the Companies Act, which contains numerous provisions for the recovery of amounts paid out by the company. Additionally, any creditor or member who considers that a company is or will be unable to pay its debts, but is capable of being rescued, may apply to the court for the company to be put under the control of a 'judicial manager', who will be required to develop proposals for the restructuring of the company.

BUSINESS RELEVANCE OF ACCOUNTING AND AUDITING AT THE SME LEVEL

Accountants in public practice (referred to as 'public accountants' under the Singapore Accountants Act) are widely viewed in Singapore as providers of all-round business support to SMEs. As well as the core, regulated services of preparing financial statements and tax computations, accountants are engaged by many SMEs to advise on and add credibility to firms' applications for finance from banks and for support from the various SME programmes operated by SPRING. When applying to banks, local SMEs are typically required to provide financial information for the last three years, regardless of whether they are required to prepare and file accounts on the public record. (If the owners of small sole proprietorships do not file their accounts, tax assessments of the individual owners may also be taken into consideration.) Most banks will, however, usually require personal guarantees and collateral from company directors rather than relying on financial reports alone. As in other jurisdictions, this extension of lenders' due diligence beyond the corporate entity itself operates as a practical restriction on the true value of limited liability to the owners of the business, effectively placing them in much the same position as sole proprietors or partners.

DE-REGULATION OF COMPLIANCE OBLIGATIONS FOR SMES

As outlined above, ad hoc measures have been taken over a number of years to address concerns that regulatory obligations were disproportionate to their benefits at the SME level. Accordingly, over the last decade, reforms have been introduced to allow companies to be set up with a single member, private companies have been allowed to dispense with the requirement to hold AGMs and, of course, exemptions from the requirements to have accounts audited and to file accounts were introduced via the EPC.

The steering committee that was established by the Ministry of Finance in 2007 to review the structure of company law in Singapore issued a comprehensive set of proposals, for comment, in 2011. The committee reviewed, among many other issues, the existing rules governing the public accountability of private companies, especially EPCs.

The committee proposed abolishing the category of EPC completely. It came to this conclusion on two counts. First, it argued that the current provision for EPCs to be totally exempt from filing accounting information on the public record may have the effect of prejudicing third parties that deal with an individual EPC, given that they will not thereby be able to verify its financial position (even though that company will have filed a declaration of solvency as a condition of not having to file accounts). Second, it argued that the criteria that govern the exemption from audit of small EPCs should be expanded. On the strength of feedback from stakeholders it concluded that the exemption criterion, ie a revenue threshold of S$5m, was too low and should be increased. It also concluded that a single criterion, based solely on revenue, was inadequate, in that it did not take account of other elements that might have a bearing on whether or not audit exemption was appropriate.

The committee recommended, therefore, that the EPC category should be abolished. Differential provisions for publication and audit would, in future, be organised by reference to size-based criteria. Private companies would qualify for audit exemption if they were classed as 'small' by meeting two out of three criteria, covering revenue, gross assets and employee numbers; the revenue threshold would be raised from the current S$5m to S$10m. As regards the publication of accounts, the committee proposed that 'small' companies, as determined via the same formula, would all be obliged to file information on the public record, but they could choose to file a new, reduced range of information as an alternative to the information that they would include in their full accounts prepared under accounting standards.

The government's final decision on the committee's recommendations was published in October 2012. It did not agree with the recommendation to abolish the EPC on the ground that to do so would impact negatively on Singapore's competitiveness. It thus decided to retain the concept of the EPC and the exemption from filing, and consequently to reject the idea of obliging all companies to publish accounting information. It did, however, accept the proposal to extend the parameters for claiming audit exemption.

SUMMARY

Singapore has a highly business-friendly culture that positively encourages incorporation at all levels, including the SME level. It also has a long-standing commitment to the idea that public accountability on the part of companies, including SMEs, is both the logical corollary of the granting of limited liability status and a positive tool for encouraging business activity by allowing third parties access to information about companies' financial health. The reforms put forward by the government steering committee on company law in 2011 differ from initiatives undertaken in the recent past in other comparable countries since they are motivated, in part, by a desire to see more, not less, financial information being published by small companies.

The streamlined regime for EPCs, as introduced in 2003, within which the smallest companies do not have to publish accounting information or to have it audited, has demonstrated that there is an appetite in Singapore, as there is in other countries, for the non-disclosure of financial information. For the government and the business community the challenge, which is being addressed within the current company law reform process, is how to strike the right balance between the desire for confidentiality on the part of small business owners and the public policy ideal of transparency. Despite strong support for abolition of the EPC concept and the introduction of mandatory filing for all companies at the SME level, the government has decided that the business case for privacy overrides the case for transparency at this level.

The company law regime in Singapore combines rigorous rules on internal financial management and the preparation of annual accounts with extensive protections for stakeholders at all levels. Information on all companies is publicly available from the companies' regulator. Directors are liable to the company's creditors where they make an unlawful dividend payment, and may be made personally liable for their company's debts and liabilities, without limitation, where the company has been conducting business fraudulently or has incurred debt that, at the time, the company had no reasonable or probable expectation of repaying. Also, as a condition of being allowed to take advantage of the exemption from publishing accounts, the directors of small companies are required to make declarations of solvency, with stiff criminal sanctions for those who make the declaration without having reasonable grounds for doing so.

Summary and conclusions

In all four countries surveyed, the limited liability vehicle is a business format that is not only seen as suitable for SMEs but is very popular with them. In all cases, the limited liability format allows entrepreneurs to conduct their affairs in a way which separates their own financial interests from those of their companies. This technicality is intended to promote entrepreneurial activity by reducing the risk of ownership. But at the same time it increases the risk run by third parties who deal with the company. The focus of this report has been on the safeguards that the law in the four countries puts in place as a corollary of the granting of limited liability status to small privately owned companies, and in particular on the role that the processes of accounting and disclosure play in this context.

In the UK, all companies are regulated by an integrated company law framework which, inter alia, requires them to keep accounting records and to prepare annual accounts on a standardised basis. This framework is supported by a comprehensive database of information on individual companies' affairs which is publicly available and can be inspected by any person. The range of information that each company must file includes information on its official address, registration number, director and shareholder details, as well as its annual accounts. Any party is able to access any of this data on the public record for any purpose, whether related to business decision making or otherwise. A significant amount of business use of published company information is still apparently made by third parties. While this position still holds, from the 1980s onwards a succession of reforms aimed at reducing business burdens for smaller companies has resulted in reduced requirements for the filing of accounting information by small private companies. Such companies now need to have their accounts audited only if 10% of their shareholders demand it.

While Australia is similar to the UK in that private companies operate within an integrated company law framework, and it requires a wide range of company information to be filed on the public record for general inspection, Australia has determined that small proprietary companies should not, as a rule, be expected to publish or even prepare annual accounts (although their shareholders may require them to do so). Accordingly, accounting information per se is no longer seen as an essential safeguard for creditors and other parties at the SME level. That said, other statutory provisions provide counterbalancing safeguards for stakeholders that are not present in UK law: exemption from the requirements on accounting and audit is granted on condition that the directors of the company concerned make a declaration of solvency; companies may pay dividends only if the proposed payment is fair and reasonable to the shareholders as a whole and if the payment does not materially prejudice the company's ability to pay its creditors; holding companies may be liable when their subsidiaries trade recklessly; and the circumstances in which individual directors may be made personally liable for the debts of their company are more numerous than is the case in the UK – in particular directors may be held personally liable for their company's unpaid tax bills.

Singapore introduced a new light touch regime for SMEs in 2004, and this affords exemption from the requirement to file annual accounts to all 'exempt private companies'. Companies that do not file accounts are still, however, required to keep accounting records and to prepare annual accounts on a standardised basis. For these and all other companies, strict rules apply to dividend decisions and any director who allows a dividend to be paid other than out of allowable profits becomes personally liable to repay the excess to creditors. Directors may also be made personally liable for the company's debts and liabilities, without limitation, where it is found that the company has been conducting business fraudulently or has incurred debt that, at the time, the company had no reasonable or probable expectation of repaying. Singapore has recently been reviewing the measure that allows exempt private companies to opt out of filing accounts, on the basis that, while evidently popular with many companies, this deprives third parties of potentially useful decision-sensitive information. The government's final decision on this matter has, however, been to retain the EPC in its current form in the interests of proprietorial privacy.

Of the four SME corporate models surveyed, the US LLC experiences the least extent of regulatory intervention in the conduct of its affairs (but the distinction between the company and its owners and controllers is less distinct in the US than it is elsewhere). LLCs are much like partnerships in that they are substantially free to organise their own internal affairs as they see fit (and they are taxed on a transparent, or 'pass through', basis). They are subject to far fewer obligations as regards public accountability than companies in the other three countries, and are not required by company law to publish annual accounts or even to prepare them (although the tax authorities require detailed financial information). Minimal information on individual companies' affairs is placed on the public record meaning that third parties cannot access such information to evaluate a company's financial position. The principal stakeholder safeguard imposed by company law is that directors are liable to repay to their company any amount that they pay out as dividends over the allowable limit. Some additional safeguards are provided by other branches of regulation. The tax authorities have the power to impose very substantial penalties on companies and their directors for non-compliance with the tax rules while, in bankruptcy, trade creditors enjoy privileged rights to repayment; when a single-member LLC (the most common kind) becomes bankrupt, that single member is likely to be dealt with as a sole trader, in which case the corporate veil will be pierced and he or she will assume full responsibility for the company's debts.

This report emphasises that it is no longer the global norm for the smallest private companies to be subjected to regulatory requirements to prepare and publish annual accounts. Even in Singapore, where there is a long-standing public policy recognition of the business-usefulness of accounting information placed on the public record, small privately owned companies have since 2004 been entitled not to publish their annual accounts. The opportunity to avoid publishing accounting information is clearly popular with a great many small companies in all the countries reviewed.

It must also be acknowledged, however, that in both Singapore and Australia, and to some extent the US also, the entitlements not to prepare and/or publish accounts are counterbalanced by a number of other provisions that have the effect of ensuring that the risk assumed by stakeholders is mitigated, usually by the assumption by company directors of greater levels of personal responsibility. The principal way in which this happens is through the making of a declaration of solvency as a condition of not having to prepare and file accounts, but there are in those countries an extensive range of circumstances in which personal liability may be acquired by directors. While the circumstances in which this may happen apply across the range of companies, and not just to SMEs, personal liability potentially has a particularly heavy impact on small companies, where the absence of explicit requirements to exercise responsible financial management might, on the face of it, be expected to lead to lower levels of care. A heightened risk of personal liability may therefore amount to a considerable incentive for directors of small companies to ensure that their companies' affairs are properly managed, regardless of the presence or absence of elaborate legal requirements to do so.

The availability on the public record of up-to-date information on SMEs' financial affairs is still seen by many as having value in both the UK and Singapore, not only for the sake of transparency but also as a tool for facilitating trade by and with SMEs. The public availability of information on companies and their ownership structures will also have a practical information value to businesses and professional advisers who have obligations to carry out client checks in the context of anti money laundering requirements. Note the revised recommendations on this matter issued by the Financial Action Task Force in 2012 in its call on all countries:

> to ensure that there is adequate, accurate and timely information on the beneficial ownership and control of legal persons that can be obtained or accessed in a timely fashion by competent authorities.

Where information on company performance and ownership is not generally available, the onus is placed on third parties, including those thinking of doing business with an individual company, to conduct whatever enquiries they can about the credit worthiness of the company.

The following conclusions can be drawn from the foregoing.

1. The authorities in all the four countries surveyed recognise that those who do business with limited companies take on a degree of risk, and they therefore insist that stakeholders are compensated for that risk. The four countries have different approaches to the question of exactly how accounting and disclosure should contribute to this process of reducing stakeholder risk.

2. Where company law requirements for SMEs to prepare and/or publish accounting information are not imposed, the tax authorities can and do act to impose basic standards of discipline on financial management at this level. In Singapore as well as the UK, the annual accounts prepared by companies form the basis for the computation of their tax liability; in the US and Australia, detailed accounting information is required to be submitted by each LLC and proprietary company direct to the tax authorities, the main difference between the latter two regimes and the first two being that the information provided in the latter cases does not have to be provided on a single standardised basis. Where financial information is provided only to the tax authorities and is not made systematically available to third parties, there is,

however, an absence of transparency, although again the relevance and business-usefulness of that information, where it is published for general inspection, is likely to be affected by the amount of information that has to be disclosed and the level of detail provided.

3. The absence of legal requirements to prepare and/or publish accounting information will not in itself affect the business case for the engagement of qualified accountants by SME companies. Aside from the fact that companies will invariably need expert assistance with their tax obligations, accountants are widely seen in all four countries as providing an essential business and financial support service to SMEs.

4. What is considered to be an appropriate regime for accounting and disclosure by SME companies in all countries is likely to take account, increasingly, of cost-benefit considerations, and especially the goal of keeping compliance obligations and compliance costs to the minimum justifiable level. It is also likely to be heavily influenced by the wider business culture of the country concerned, and the extent to which transparency in relation to corporate activities is seen as justifiable and desirable.

5. Any regulatory regime for limited companies is likely to comprise an interrelated system of checks and balances. Where rules on accounting and disclosures exist, they will form part of such a system, and where they do not, compensating measures are likely to be present. The optimum regime cannot, therefore, be considered in isolation from consideration of how the framework provides appropriate safeguards overall for investors, creditors and the public interest. Although small companies in Australia, for example, are not bound to prepare or publish annual accounts, the financial interests of their stakeholders are addressed by requirements for directors to make an annual declaration of solvency and for decisions on distributions to take stakeholders' interests expressly into account. In countries that have more extensive and standardised requirements governing accounting and public disclosure, such as the UK, those measures may be seen as a substitute for the more stringent rules on personal liability that exist in other company law regimes. The particular contribution that accounting and disclosure can make to the goal of protecting stakeholder interests and the public interest in any individual company law regime will accordingly be a function of the wider regulatory framework within which companies exist. Determining where the optimal balance lies at the SME level will invariably involve an assessment, not only of the costs and benefits of mandating standardised accounting and disclosure practices, but of how they coexist with other measures that provide necessary protections for stakeholder interests. In this spirit the World Bank report *Doing Business 2013* says that:

The economies that rank highest on the ease of doing business are not those where there is no regulation – but those where governments have managed to create rules that facilitate interactions within the marketplace without needlessly hindering the development of the private sector…In essence, it is about smart business regulations, not necessarily fewer regulations.

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Appendix

Comparison of legal requirements for reviewed SME companies in the four countries – the private limited company (UK), the limited liability company (USA), the proprietary company (Australia) and the exempt private company (Singapore)

	UK	USA	Australia	Singapore
Are all companies required by law to produce annual accounts?	Yes	No	No	Yes
Where companies are exempt, does the law provide for shareholders to insist that their company produces accounts?	N/A	No (NB they may decide to do so voluntarily)	Yes – 5% of shareholders may insist	N/A
Are all companies required by law to publish annual accounts?	Yes (though modified versions of the full accounts may be published by small and medium-sized companies)	No	No	No – exempt private companies are not required to file accounts
Where companies are not required to publish annual accounts, is there any equivalent document that companies must publish instead?	N/A	No	Exemption is on condition that the directors of the company make a declaration of solvency	Exempt private companies are required to make a declaration of solvency as a condition of exemption
Are all companies required to have their accounts audited?	No	No	No	No
What is the basis for exemption from audit?	Companies that qualify as 'small' by reference to size criteria are exempt, as are companies whose parent guarantees their liabilities	N/A	'Small' proprietary companies are only subject to audit if this is insisted upon by at least 5% of shareholders	Small exempt private companies are exempt from audit
What restrictions are placed on company distributions?	Distributions may be made from distributable profits which are calculated in accordance with UK GAAP	Distributions may be made if, after a distribution, the company is able to pay its debts as they fall due or the assets are greater than its liabilities, including those owed to preferential creditors	Distributions may be made if the company's assets exceed its liabilities (calculated in accordance with Australian GAAP); if they are fair and reasonable to shareholders as a whole; if they would not materially prejudice the company's ability to pay its creditors	Distributions may be made out of 'allowable profits', calculated in accordance with Singapore GAAP.
How is the company taxed?	The basis of the company's tax liability is its annual accounts, calculated in accordance with UK GAAP	The company is not taxed as an entity; individual members are taxed on their share of the company's profits, which may be calculated on a cash or accruals basis	Companies are taxed on the basis of financial information provided via its corporate tax return (NB a company's directors can be made personally liable for unpaid corporate tax)	The basis of the company's tax liability is its annual accounts, calculated in accordance with Singapore GAAP

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