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Small Business Study
Productivity Commission
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Dear Ms Underwood

Productivity Commission: Issues Paper: Regulator Engagement with Small Business

The Institute of Public Accountants (the Institute) takes this opportunity to respond to *Productivity Commission: Issues Paper: Regulator Engagement with Small Business*.

The Institute has over 24,000 members, students and academics throughout Australia and around the world. Our members are involved in small business as advisors or owners, and deal with regulation and its impact on almost a daily basis.

The Institute welcomes the opportunity to respond to this issues paper, which addresses a matter of vital importance to small business.

While all businesses have concerns with the regulatory burden, it invariably falls more heavily on small businesses that neither have the time nor the resources to devote to regulation as well as management. Efforts to ease the regulatory burden and better educate regulators on how to interact with small business are essential.

It is appreciated that in a complex economic environment regulation is necessary; however, it is equally important that principles of regulatory development should be reflective of the notion that more regulation is not necessarily better. On this count, Australian regulators should follow the lead of the European Union (EU) in adopting a "Think small first" approach to regulation.

Better interaction between regulators and small business is important, and regulators need to have a more comprehensive appreciation of small business issues. While it is not possible to remove all regulation, it is possible to minimise unnecessary impacts.

Please contact our Senior Policy Adviser, Reece Agland, should you wish to discuss the details of this submission further.

Kindest Regards

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What, if any, regulatory problems arise from the absence of a consistent definition of small business?

The Institute of Public Accountants (the Institute) believes there are a number of regulatory problems that arise from the lack of a consistent definition.

The primary problem is that the definition makes it hard for a small business to determine whether it is covered. This can mean the small business either misses an opportunity or is subject to the wrong regulatory regime.

In addition, meeting the definition in one circumstance; may not mean the definition is met in all circumstances. A small business may believe it is covered, yet the regulator may have a different view. This could lead to unexpected fines or penalties.

Additionally, a small business may not be aware it should be so classified and then subject itself to the wrong regulatory regime. A more consistent approach would provide greater certainty regarding the nature of the regulatory environment.

Different definitions can cause confusion among regulators, and staff need to be fully trained regarding different definitions and their application.

Small businesses are generally time poor and unable to research each definition.

Having a simple definition that applies to the majority would be of assistance.

If a single definition of small business was considered appropriate, what factors would need to be taken into account in its development? If such a definition is appropriate, should it be based on a measure of firms size or organisational characteristics?

The Institute believes that while it is not possible to set a simple definition to meet all circumstances, there are characteristics of a small business that could be used to address the overwhelming majority of cases. Should a regulator wish to set a more specific definition for a specific purpose it should explain the rationale for having done so.

The Institute supports a multi-pronged definition of small business. A number of characteristics could be defined and if a business meets more than one it may be so classified.

One factor to be considered is the number of employees; a relatively simple and easily understood measure. On this matter, the Institute is of the view that employee numbers should be determined with reference to "Full time equivalent" (FTE) over a 12 month period. This is because many small businesses hire staff on a casual or part time basis. If the number of employees is set at a strict number (e.g.: 20), then many small employers who use part-time and casual staff might quickly exceed this number, and be incorrectly excluded and not treated for regulatory purposes as a small business.

The increased casualisation of work and employment of part time and casual workers means numbers should be determined with reference to FTE rather than an absolute number which takes no account of hours worked.

FTE should be calculated over a 12 month period. Many small businesses have peaks in the business cycle. This is particularly so in the horticultural sector where large numbers may be employed as pickers and seasonal workers. For a brief period, numbers may be large. However, when considered annually the number of employees could fall well short of the number noted.

Accordingly, employment should be calculated on a FTE basis over a 12 month period. While this may make the definition more complicated, it better reflects modern employment arrangements.

Another factor to be considered is turnover; noting that some business with small employee numbers (mechanisation and computerisation) may be classified as small although turnovers may be substantial.

It is noted that the usefulness of turnover as a determinant is invariably compromised by the effect of inflation; setting aside the fact that debate continues over the very basis on which turnover can be measured.

Despite these weaknesses; the Institute favours turnover as a factor to be applied when defining a small business.

Another potential determinant would be asset levels; the challenge being that the IT, telecommunications and construction sectors are capital and asset intensive, but invariably have low employee levels.

Clearly, more than one test needs to be applied when considering whether a business is “small” under the Corporations law.

It is recommended that a business satisfy at least two of the following tests in order to be defined as a small business:

- Number of employees (say 25 or less full time equivalent over 12 months)
- Turnover (say \$25 M or less)
- Assets (\$50 m or less)

Are there any benefits from having definitions of small business that are specific to particular regulatory purposes?

The Institute believes that while it is preferable to have a single definition of a small business, there may be times when it is appropriate to have a different definition to meet specific regulatory outcomes. This is particularly so in relation to special tax exemptions.

However, the Institute remains of the view there should be a default small business definition and that if a clear rationale must be provided in those cases where the regulator wishes to use a different definition.

What are the key factors that influence how regulators engage with small business and in what manner are individual factors influential?

Some regulators treat all entities equally. While this may have some basis on the grounds of uniformity, it can lead to perverse outcomes and expectations. Small businesses do not have the capacity to absorb regulatory change as quickly as large businesses. They also lack the resources to respond in the same way and legislative changes change prove difficult both in their interpretation and in ensuring that practical changes are made in a timely fashion. Furthermore, larger businesses have specialist personnel to deal with regulators and the impact of sudden change.

Some regulators appreciate the differences in capacity and tailor their requirements and expectations accordingly. Some have different forms or require different amounts of information. Some may allow a small business more time to adapt. Regulators that do not permit such differentiation often have a poor relationship with small business.

The size of the regulator is generally not a factor. Some large regulators, such as the Australian Taxation Office (ATO), recognise small business and its different needs and capacities. The ATO deals with small business differently and has dedicated resources for this purpose.

The Australian Securities and Investments Commission (ASIC) on the other hand have committed to developing better relationships with small business.

The size of the regulator is not normally an indicator of flexibility or of a willingness to work differently with small businesses.

A further factor affecting relationships is whether the regulator takes an educative or rules based approach to regulation. Those that provide education and enforcement are generally seen as being more understanding of small business. Small business breaches are often accidental and the party may be unaware that a breach has occurred. In these circumstances small businesses appreciate an educational or instructional rather than a penal approach.

The Fair Work ombudsman may adopt a legalistic approach to breaches and impose sanctions for a range of infractions. For many small businesses the Fair Work laws are complex and confusing and it is often easy to breach the rules without intent. If the Fair Work ombudsman

took a more educative approach many small business would find it easier to comply. It is accordingly recommended that regulators adopt an educative approach to enforcement.

Regulators that have greater control over the development of policy and law are more able to adapt regulations to circumstances. They tend to be freer to make alternative arrangements and are quicker at making changes where the marketplace has shown the need. If regulators are to better deal with small business they need this flexibility.

Regulators actively involved in the development of policy are often better able to influence the development of law. Removing the ATO from the development of tax policy, while ensuring greater transparency, has we believe adversely limited the ATO's ability to contribute to the development of policy and regulation and limited their ability to be proactive.

What are leading regulator practices in relation to:

- ***Monitoring of business awareness and understanding regulations?***
The leading practices are those that have a regular connection with small business through working groups and committees with members from business and the regulator. Such forums allow regulators to talk with small business and their representatives to find out how much they know, what they need to know, and the best way to get information out to businesses. Regulators can also conduct sample polling to discover the levels of understanding. The ATO from time to time uses this approach in order to clarify how well new policies and laws are understood.
- ***Ensuring regulatory decisions and advice are clear, accessible, consistent and timely?***
Ensuring that all documentation is in 'plain English' is important. Businesses are time poor and need simple and understandable information.
- ***Addressing the information needs of small business including those located in regional areas or those with owners/managers of a non-English speaking or indigenous background?***
A clear and easy to use web presence is invaluable. The ATO website has plentiful information which is often difficult to locate.

The ATO also offers many of its publications in other languages and has developed material for indigenous Australians.

Most if not all business have web access, and it is increasingly the main source of information. Government agencies need to take advantage of this. However, many government websites are information heavy and with excessive jargon. People need to be able to find information quickly.
- ***Ensuring the information business provide is necessary and that feedback about the impact of such requirements are taken into account?***
It is important that government agencies and regulators create forums with representatives of small business and small business owners in attendance. Regulators at those forums need to take industry comments at these forums very seriously. Many potential problems can be headed off by listening. Regulators should also place those responsible for developing regulations into a small business so they can better understand how businesses are run, the time it takes to comply with requirements and other difficulties. If they experience this pain they might be more understanding of concerns and develop more effective regulation.

Do compliance and enforcement approaches and the decisions of regulators appropriately reflect the likelihood and consequences of non-compliance?

- ***Do regulators respond proportionately to compliance breaches? Do they have enough flexibility in terms of how they respond?***
Some regulators do a better job than others and differences of commitment exist within regulators. Some ATO sections are better at taking into account individual circumstances. Some are understanding of the difficulties of small business and play both an educational and enforcing role. Some personnel have a better understanding

and thus are better able to engage with businesses. Others display a lack of understanding and tend to adopt a formal approach.

It is important that regulators have not just the flexibility to take into account personal circumstances; but that they educate staff to better understand the nuances of the entities they regulate and the laws they are enforcing.

- ***Which regulators most effectively manage risk and what particular strategies have worked?***

The ATO has gone some way in developing risk strategies. Each year it publishes a listing of industries or sectors which will be the focus of forthcoming compliance activities. The ATO has become better at identifying those industries that need closer attention; with reference to its own risk modelling. ATO compliance work has also identified particular problem areas and it listens to the public and those in industry about risk factors.

Conversely, the ATO has recently used metrics to define how a business should look and operate. Those that fall outside norms are subject to ATO scrutiny. There have been complaints about metrics. It is felt they are not accurate or flexible enough to reflect the real world. There is concern the metrics are too heavily relied upon and that business specifics are not taken into account. The cost in time and effort in these ATO reviews/audits is enormous when based on faulty data.

Whilst risk analysis is important, metrics should not be given undue weight.

What factors cause individual officers to diverge from appropriate behaviour?

As noted, one factor can be an overreliance on metrics without regard to the business. There may be regional variations or peculiar circumstances at play. A good regulator balances data with industry understanding based on experience and personal observation.

Regulators must spend time in the industry to understand peculiarities. An experienced regulator will be better able to tell when something is not right and to better make individual assessments.

A further factor is that some officers appear to have the view that their role carries with it a wisdom that should never be challenged. This can lead to overconfidence, an unwillingness to listen and in some instances: “bully-boy” tactics.

What co-ordination exists between regulators to share business data and avoid overlap and duplication in forms and data requirements?

There is insufficient co-ordination and sharing. Some regulators are better at sharing data and implementing formal information sharing processes (between the ATO and ASIC in relation to SMSF auditors). It is however normal for each to require their own information in their own format.

Standard Business Reporting (SBR) is going some way towards alleviating some of these problems but the rate of adoption is slow.

Often individual regulators operate in isolation and are reluctant to give powers and information to others. Even within individual regulators there often appears to be a lack of information sharing or commonality in forms and procedures.

The Institute is a strong supporter of “reporting once, reporting to many”. All information is provided at one time and accessed and shared by different regulators. In a world of information technology and electronic forms, the number to be completed by business is surprising, often with the same information for different regulators.

Better implementation of SBR will see improved information sharing between agencies and greatly assist small business wishing to place relevant information into their accounting software for regulators. Unfortunately there appears to be insufficient support for SBR from both regulators and industry at this time.

To what extent do regulators use emerging technologies, such as online tools, to improve access to information and increase compliance?

This depends on the size and resources of the regulator. The ATO and ASIC have begun to embrace online forms and tools. The ATO has developed its online tax return, online brochures in different languages and a raft of other information and tools. It is a leader in this area. ASIC has moved to an online platform as the primary mechanism. In some instances it is more expensive to deal with ASIC through paper than online. Both should be recognised for their online work. However, smaller less well funded regulators often lack the resources to develop online tools. State regulators also tend to be behind in their use of technology compared to the larger well funded commonwealth counterparts.

How do regulators' engagement approaches affect the nature and impact of compliance costs on business? What are some examples of regulators' engagement approaches that impose excessive or unnecessary costs on business?

An ongoing example of regulators being too prescriptive and excessive in the paperwork burden is the ongoing registration of SMSF Auditors by ASIC. A number of problems have emerged that have caused concern.

Example 1. ASIC currently regulate Registered Company Auditors (RCA), and assured the accounting profession that RCA's would enter with a minimum of regulation. However, many RCA's are being required to provide copies of their accounting qualifications even though these may have been obtained many years ago. Rather than accepting that those who audit large companies have the knowledge and skills needed; the regulator continues to seek information which may, due to the passage of time and the tyranny of distance; be difficult to locate.

Example 2: ASIC has a "show cause" power that allows the registration of SMSF auditors when they do not strictly meet requirements; but are otherwise able to show cause as to why they should be regulated. Some analysts claim no such power exists, even though it is in legislation.

Example 3: ASIC requires an auditor to have an accounting qualification of at least three years and an audit subject either in their accounting qualification or as part of their program with a professional accounting body. Some analysts are informing applicants that they are required to have both audit in their underlying qualification and from their professional body. A further problem is ASIC's insistence on full academic transcripts; although the law and relations regulations do not require this.

Many members have complained that ASIC seems to be finding minor issues as a reason to not issue a registration. It is expected that between 6000 and 82000 applications will be received by ASIC up to the cut off date of 30 June 2013. As of mid March 2013, ASIC had only approved 400 applications of over 1900. There is concern that the overly legalistic and prescriptive nature of ASIC's process may mean there are not sufficient SMSF auditors registered by 30 June 2013.

The accounting profession offered to work with ASIC to develop processes and find ways to minimise compliance burdens. These offers were ignored.

We believe many issues could have been avoided if there was proper consultation and an open mind on how people could demonstrate competence.

Under what circumstances, if any, is it appropriate for regulators to adopt a different engagement approach for small business?

There is a difference between taking a different engagement approach and applying the law differently. The law should be enforced consistently, irrespective of who is being regulated. However, good regulators are aware that small businesses are different in management practices and resources. The way a regulator "engages" can be different, yet still result in a fulsome implementation of the law.

With small business; education is preferable.

Small business also needs more hands on support. They do not have access to internal resources to assist with regulatory requirements. It is generally the owner of the business who will be responsible. Large businesses will conversely have dedicated resources to address regulatory obligations.

The Institute supports the EU “think small first approach”. It is much easier to upscale requirements to large business than to downscale requirements to small business. Often regulations are written with regard only to the “big end of town” and a desire to maximise information. This then leads to over regulation and imposes significant burdens on small business. A preferred approach is to identify the minimum required to meet regulatory objectives and how small business can deal with it. It may then be possible to upscale requirements when dealing with big business.

Often regulators request information that is unnecessary, but “nice to have”. Often this additional information is surplus to requirements or difficult to collate. Excessive information often diverts attention from the rationale of the regulation. It is therefore important that those that develop policy and write regulations do so in a minimalist way. Bigger is not better when it comes to regulation.

Furthermore, all businesses are time poor, and while large businesses have resources, these would be better spent growing the business rather than supporting regulation.