News

Audit reports – what about credibility and integrity?

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I always contend that trade credit is the oil that keeps the commercial wheel turning in an economy. But money costs money!

Credit does not come for free and although it may help suppliers to sell and maintain competitive advantage in the market, it may carry a substantial element of financial risk to the supplier/trade creditor.

Trade creditors should only invest their money in customers, by means of granting them credit, if they can reliably analyse and evaluate the risks involved, and forecast their expected return. They should also factor in the value of their product at point of sale.

Financial statements and audit reports give a snapshot of what happened to a business in the past. Nevertheless, having at least three consecutive statements and reports should assist a trade creditor to determine the financial trend of a prospective customer. But this can only happen if the trade creditor is lucky enough to obtain such financial information.

Trade creditors are truly working against all odds. Besides the element of timing, which makes financial statements outdated by the time they are published and made available to the public, there are other limitations with financial statements.

A number of companies in Malta are not filing their financial statements with the Registrar of Companies as they should, while still trading and requesting credit from their suppliers. Is this ensuring financial transparency in our business economy? Is the penalty fee charged for not filing the accounts by the Registrar of Companies and the mechanism behind this effective? Is it time to revise and improve the system to ensure that all companies are filing their financial statements according to law?

Another major limitation emanates from the Companies Act itself. Clause 185 of the Companies Act states that companies which on their balance sheet dates do not exceed the limits of two of the three following criteria: balance sheet total – €2,562,310.74; turnover – €5,124,621.48; average number of employees during the accounting period – 50, will be designated as ‘small companies’ and may draw up abridged balance sheets and abridged layouts of profit and loss account.

Financial statements and audit reports give a snapshot of what happened to a business in the past.

Whoever is involved in credit management knows that abridged accounts offer very limited financial information, and limited financial information simply means less transparency and lack of full financial disclosure leading to a higher degree of risk exposure when making credit decisions.

Additionally, for a small business economy like Malta, a turnover not exceeding €5.1 million cannot be considered small by any reasonable measure.

On the contrary, with small also being defined as up to 50 employees and such businesses representing the absolute majority of the local business community, the sector represents a substantial chunk of any trade creditor’s portfolio.

These figures were imposed on us by the EU but given the considerable differences in terms of size and culture between the member states, what is good for the goose is not necessarily good for the gander.

Nevertheless, reliable corporate financial statements and auditor’s reports are indeed valuable to the creditors who are after clarity and accuracy in the audited accounts and in the operation of the business, in order to compare potential credit investments and assess risks involved when granting and managing credit.

But reliable and full financial disclosure is not only required for credit management purposes. Corporate financial transparency makes it easier for the business owners and directors to determine where they stand in relation to their peers.

Benchmarking the financial performance would help to identify weaknesses and thus find ways to improve; this would result in a more profitable business community, which would have a positive effect on the economy at large.

Full and audited financial disclosure and transparency are also crucial to mitigate and prevent corporate scandals. Audited financial statements should, therefore, be more reliable and thus more credible to attract more investment and enhance economic growth.

In view of the current situation, the Maltese authorities should seek ways of ensuring honesty and fairness in business transactions and corporate finances, and to prevent business fraud from taking place.

Investors and creditors can only regain credibility in the corporate finances through employing proactive measures – a better-safe-than-sorry attitude.

It may be the time to employ forensic accountants to audit the corporate financial accounts whenever needed. It may also be the time to consider the debatable issue of how necessary it is to switch auditors regularly to alleviate fraud and to ensure that the audited accounts truly reflect the corporate finances.

Switching auditors on a regular basis would lead to more frequent access of the company’s accounting records and more requests for information and explanations from the companies’ officers as the auditors would think necessary for the performance of their duties, as the Companies Act itself specifies.

MACM believes that credit management is all about being proactive and due to the limitations of financial statements and their reliability and integrity, it provides a more comprehensive approach to all Maltese businesses involved in granting and managing credit.

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