

The Business OBSERVER

Issue 37 | October 22, 2015

Financial transparency from full disclosure



Josef Busuttill

Trade credit does not come for free. It costs money and also carries an element of risk.

To ensure that customers requesting credit are trustworthy and can reasonably honour their commitments and pay their dues on time as agreed with their suppliers, the latter should analyse and evaluate the risks associated with the specific customers prior to granting them credit.

To analyse the credit worthiness of prospective customers, suppliers require reliable, complete, accurate and timely information. For this purpose, there exist a number of credit information sources available to the trade creditors and financial statements and audited reports of companies are one commended source.

Financial statements and audited reports give a snapshot of what happened to a business in the past. Although they may not be considered as timely, having at least three consecutive annual statements should assist a trade supplier to determine the financial trend of a 'prospective' customer requesting credit. But this



can only happen if the supplier is lucky enough to obtain such financial information!

Besides the element of timing, which already makes financial statements outdated by the time they are published and made available to the public, there are other limitations with financial statements and the recently published Bill, which introduces amendments to the Companies Act and implements the Directive 2013/34/EU, only makes it worse to the local business community selling on credit.

The Bill defines small companies which on their balance sheet do not

exceed the limits of two of the three following criteria: balance sheet total - €4 million; turnover - €8 million; average number of employees during the accounting period - 50.

This definition is in line with the Directive 2013/34/EU but in Malta, it is estimated that 95 per cent of the local registered companies are not only small but micro entities by definition. This means that the local trade suppliers will not find the necessary information which was once filed by all the registered companies and made available to the public by law.

Exemptions suggested by the Bill may have negative consequences

for the local business community in the future, for various reasons.

The successful business should know at all times its financial state, and that would entail the maintenance of detailed accounts. Experience in the local credit industry asserts that "inadequate", "poor", or just plain "bad" management represent the major cause of business failure. MACM believes that the maintenance of detailed accounts is a business discipline which must be a fundamental requirement of any company. The whole concept of abridged accounts and exemptions to file financial statements sends out to the business sector

entirely the wrong signals - "you need not do this" - and actually encourages poor management.

MACM also argues that corporate financial transparency makes it easier to business owners and directors to determine where they stand in relation to their peers in the market. Benchmarking the financial performance would help to identify weaknesses and thus finding ways to improve; this would result in a more profitable business community which would have a positive effect on our economy at large.

Additionally, 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.

Anyone who is in business knows full well that unsecured trade credit is the lifeblood of business. When such legislation make it increasingly more difficult for suppliers to make sensible risk decisions they are in effect both cutting off the lifeblood and in a bizarre way actually encouraging irresponsible lending.

Limited liability, as far as corporate bodies are concerned, has always been a privilege, the privilege being that the entrepreneur can operate without the fear of losing his home or his personal assets. Privilege has to come at a price, and that happens to be full disclosure.

Josef Busuttill is the director general of the Malta Association of Credit Management.
jbusuttill@macm.org.mt

"The bill may have negative consequences for the local business community in the future"