

TAL TECH

IMPACT ASSESSTMENT OF ANNUAL REPORT SUBMISSION TIMELINESS FOR THE MINISTRY OF FINANCE

Summary

Public



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SUMMARY

BACKGROUND AND OBJECTIVES

Nearly ¼ of Estonian companies do not submit their annual reports and nearly 40% of those who do submit, submit these after the submission deadline. This creates a situation where data obtained from annual reports cannot be used to compile accurate statistics on the economy. The latter, in turn, reduces the quality of management decisions in the public and private sector. Therefore, the aim of the study is to:

- identify the causes and consequences of non-submission and late submission of annual reports;
- determine the most suitable and effective solutions that would motivate entrepreneurs to submit annual reports by the deadline.

Based on the above we propose some recommendations for improving the situation. The study searches for answers to the following research questions:

1. What are the direct and indirect consequences of non-submission and late submission of annual reports (for statistics, management decisions in the private sector, public sector)?
2. Why do legal persons submit their annual reports late?
3. Why do some legal persons fail to submit their annual reports?
4. What kind of methods are used in other countries to motivate legal persons to submit annual reports by the deadline?
5. Which possible instruments/methods could be effective in motivating legal persons to submit their annual reports by the deadline?

The study focuses on annual reports of legal persons registered in Estonia during 2010–2018. Legal persons include:

- companies (i.e. general partnerships, limited partnerships, private limited companies, public limited companies, commercial associations, excluding building associations) and
- non-profit organisations (NPOs) and foundations (excluding apartment associations).

The analyses of legal persons and NPOs/foundations are kept separate as their activity profiles and possible determinants of annual report submission may differ. Comparative statistics and regulatory comparisons are drawn from Belgium, Germany, Finland and the UK. The analysis also separates the data and results for legal persons who failed to submit their annual report (hereafter non-filers) or who submitted their annual report after the deadline (hereafter late-filers).

METHODS AND STRUCTURE

To answer the research questions, different research methods listed in [Figure 1](#) are used. The first phase of the analysis involved the analysis of raw data concerning the submission of annual reports by Estonian legal persons and a case analysis of selected countries. Simultaneously semi-structured interviews were made with representatives of annual report filers, users of annual report information and institutions involved in the organisation of annual report submission (in the Figure referred to as interviews I and hereafter referred to as representatives of related stakeholders). In September 2020 a survey amongst non-filers and late-filers of the annual reports for 2017 was carried out. Survey was sent to randomly selected 8287 legal persons. Amongst the 894 respondents 5 late-filers and 5 non-filers were selected and interviewed (referred to as interviews II in the Figure).

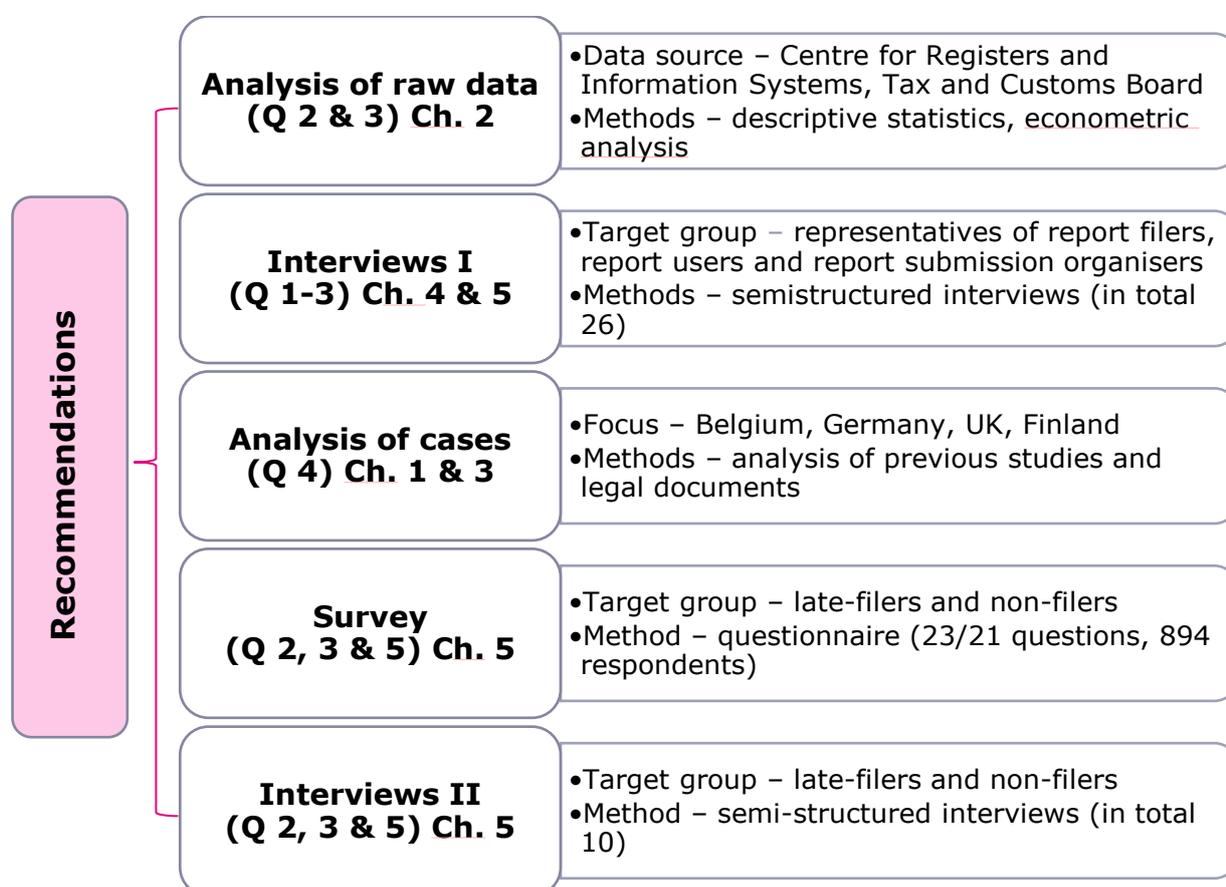


Figure 1. Methods used in the study and their connection with research questions and chapters

Source: Compiled by authors

Note: The number after Q refers to the research question presented earlier. Ch. refers to the chapters which cover the results of the applied method.

As seen in [Figure 1](#), for answering some research questions, we have been using several methods simultaneously. This allows to triangulate and validate the results. It also means

that several chapters of the study contain information obtained through the application of several methods. Based on the input, we present recommendations. While articulating the recommendations, we also take into account the feedback we received at the validation seminar held on 9 November 2020 with the representatives of related stakeholders.

The study is divided into six chapters. The first chapter concentrates on the review of previous studies dealing with the submission and timing of annual reports. It presents the studies of the four selected countries as well as the results concerning annual report submission and timing determinants on the broader scale.

The second chapter focuses on the analysis of raw data. It involves the presentation of descriptive statistics and econometric analysis (including logit, ordered logit and regression models with random effects). The analysis is based on the data from CRIS (Centre for Registers and Information Systems) and the Tax and Customs Board covering nearly 1.5 million observations. The data covers all legal persons falling under the scope of the study. The indicators of non-submission and late submission are calculated and their determinants identified. Also, the statistics of the Court Registry filings concerning the annual report submissions are analysed.

The third chapter presents the case analysis of regulations in the selected countries. It also presents the available information on the motivational measures applied.

The fourth chapter contains the results of interviews with 26 representatives of related stakeholders. It provides information on how the information taken from annual reports is used and what the consequences of untimely submission are for the public and private sector.

The fifth chapter concentrates on the causes of late submission and non-submission as well as on the possible countermeasures. The input for causes is taken from interviews with related stakeholders and when combined with the input from raw data analysis and case analysis it forms the basis for the survey questionnaire. 894 responses received enable to determine the causes of untimely filings related to the preparation, submission and publication of annual reports. The results were complemented with the input obtained from 10 interviews with selected survey respondents. An overview of countermeasures provided by survey respondents and interviews (both with the representatives of related stakeholders and late-filers/non-filers) is also presented.

The sixth chapter presents the recommendations we considered the most relevant for improving the situation based on the previous analysis and results of the validation seminar. Recommendations for improving the situation contain different preventive measures (incl. informative, rewarding, pressuring measures), punitive measures and other recommendations for creating a more efficient reporting environment.

CONCLUSION

The analysis of data showed that from 2010 to 2018 on average 23–24% of legal persons failed to submit their annual report. 28–29% of legal persons (36–39% of all filed reports) submitted the report after the deadline. 50% of late-filers were late over 71 days. These indicators are higher than in micro-enterprises in the UK and Belgian NPOs (11.6–17.2% of all filed reports). This indicates that there remains significant room for improvement in Estonia.

The data analysis also revealed that annual reports are more likely to be non-submitted or are submitted after the deadline if:

- The legal person is younger (in operation for a shorter period).
- The legal person has been a non-filer or a late-filer a year earlier.
- The legal person is smaller.
- The legal person is registered in Tallinn.
- The legal person is not liable for value-added tax.
- The legal person has failed to pay taxes on time.
- They are NPOs - file reports later than foundations.
- The company operates in a less regulated field.
- The company has a smaller management board.
- The private or public limited company has a foreigner or a private person as the largest owner.

The ones delaying the submission more are:

- Companies with a weaker financial position (losses, low liquidity, problems with the size of net assets).
- Legal persons with the accounting year longer than 12 months.
- Legal persons submitting consolidated statements.
- Legal persons having low accounting quality.

In case of Estonia, especially significant room for improvement could be seen when punishing late-filers and non-filers. During the period of investigation, 0.9% of late-filing cases could be associated with a fine warning or fine (including actual fines only in 0.5% of late-filing cases). This indicates that during 2010-2018 the total income from fines to the state has been 1.3 million euros and the potential loss in fine income has been at least 154.4 million euros.

If we compare the annual report submission deadlines in the four countries (Belgium, Germany, Finland and the UK), then Estonia is in the middle with its 6-month deadline. Although the Estonian deadline is half shorter than the maximum 12 months allowed by

the EU regulations, it remains longer than 4 months in Finland. The minimum fines applicable in the reference countries are rather similar to the 200 euros applied in Estonia ranging from 85 to 135 euros (with the exception of 2,500 euros in Germany). The maximum fine in Estonia is very similar to Finland (3,200 and 3,300 respectively) both remaining far from 50 thousand euros in Germany. It should also be considered that in the UK and Belgium the amount of fines depends on the length of the delay in report submission and also on the size of the company in Belgium. The facts gathered indicate that unlike in Estonia the reference countries are more active in applying fines: in the UK fines are applied from the 1st day of delay and in Belgium 1 month after the deadline. In all reference countries, it is possible to initiate the deletion of the company from the registry on the grounds of non-submission of its annual report.

Interviews with the representatives of annual report filers, users of annual report information and institutions involved in the organisation of annual report submission referred to the following consequences of non-submission and late submission of annual reports:

- Country-level statistics remain inaccurate and this may create reputational damage and monetary risks (e.g. if the GDP maximum revision rate is exceeded, a fine of 30-50 million euros may follow).
- Inefficient work processes and lower productivity in public institutions:
 - Lower quality of risk models and submission of needless bankruptcy applications for the Tax and Customs Board.
 - Deficient date for policy-making and implementation of support measures.
 - Data processing repetitions for Statistics Estonia and inability to publish all statistical indicators according to the international custom of 365 days.
 - Inappropriate division of support between sectors (due to missing data).
 - Obstacles for the work of Competition Authority forcing them to ask data directly from legal persons.
 - Lower quality of economic forecasts issued by the Bank of Estonia.
- Inhibition of activities by credit institutions and companies involved in credit analysis services as well as lower quality of their services.
- Lower transparency of the business environment. This mean that the bankruptcy proceedings against late-filer and non-filers are not initiated in time.

The survey and interviews carried out with the non-filers and late-filers confirmed that the non-submission/late submission occurred:

- Due to issues related to the preparations of the annual report, including especially the time-consuming nature and difficulty of its preparation, as well as the lack of employees with accounting knowledge or the lack of an accounting service provider.

- Due to issues related to the submission of the annual report, including too few reminders about the filing deadline, the difficult and time-consuming nature of the submission of the report in the Company Registration Portal.
- The least due to issues related to the publication of the annual report. Some companies and NPOs/foundations mentioned the fear of disclosure of their financial situation and some companies also referred to the loss of privacy of its owners and leakage of business secrets to competitors.

As the difficulties in the preparation and submission of the annual report can be often linked to skills, it can be concluded that Estonian entrepreneurs are lacking sufficient accounting knowledge and skills. Also, responses referred to difficulties in finding a sufficiently trustworthy and affordable accountant or service provider. Based on the survey responses, non-filers differed from late-filers by their lower level of skills and were facing greater time and monetary restrictions. Late-filers mentioned more frequently the low priority of the submission of the annual report which can be partly explained by the low awareness of the broader importance and the necessity of the information contained in the reports. The need for improving awareness was mentioned by all the interviewed and surveyed parties.

Survey respondents and interviewees mentioned the following aspects as effective instruments for improving the timely submission of annual reports:

- Among the possible negative consequences those that inhibit the everyday activities of legal persons (e.g. getting financial support) are more effective; rewarding measures are also effective.
- Legal persons could do quite a lot themselves by setting up regular accounting practices and finding a person to do it. Still, more and better support is expected in terms of information materials, simplified reporting and automation.
- It is very important to set up warning reminders and improve the usability of Company Registration Portal.
- The views of stakeholders differed the most in terms of fines. When the representatives of related stakeholders thought that improving the efficiency of fines (compared to today) is the most important measure for alleviating the delays and non-submission, the survey respondents considered fines as a secondary measure. Still, 65-66% of respondents admitted that automatic application of fines from the 1st day of delay would improve the timely submission of reports.

Based on the above-mentioned results and conclusions, we recommend improving the submission of annual reports initially through different preventive measures:

1. Information for reducing lack of knowledge – providing additional information about annual report deadlines, their importance and possible sanctions through the Company Registration Portal during registration and the information portal for e-residents <https://e-resident.gov.ee/start-a-company/>.
2. Information for reducing ignorance

- Automatic reminders by e-mail through Company Registration Portal (if possible, also to members of the management board) - 3 months and 1 month before the deadline to the risk group and 1 week to those who have inserted their report but have not pushed the approval and submission button. The risk group includes legal persons that have been operating for less than 3 years, micro-enterprises, corporations controlled by one private person or a foreigner, legal persons not liable for value-added tax, those having failed to pay taxes on time, or those who were non-filers or late-filers in the previous accounting year.
 - Drawing public attention to the topic through a social marketing campaign (e.g. "I am an honest entrepreneur and will submit my annual report on time") in May every year.
 - Continue and increase public announcements by different public and private sector representatives to explain the importance of the timely annual report submission.
 - Under the guidance of the Ministry of Finance increase the awareness of entrepreneurs through those training and teaching entrepreneurs (e.g. training firms, universities, applied universities, entrepreneurship teachers at secondary schools) and support the development of information materials on accounting or e-courses.
3. Rewarding measures to timely annual report filers:
- A rewarding sign that can be seen on the legal person's public information card at the Business Registry.
 - Providing some benefits that are not offered to non-timely filers. For example, free access to a certain number of annual reports in the Company Registration Portal, access to statistical data or creating a dashboard (similar to the manager's dashboard by Statistics Estonia) that entrepreneurs could use and which could be filled with the most up-to-date data.
4. Pressuring measure that does not require legal intervention – adding a warning sign to the legal person's public information card at the Business Registry if the report that should have been submitted by that time has not been submitted or has been filed after the deadline (can be combined with the rewarding sign based on the traffic light logic).
5. Pressuring measures requiring legal intervention:
- Set as a precondition for all financial aid provided by the state (including Kredex, Enterprise Estonia, Agricultural Registers and Information Board) that at the date of application the legal person would have submitted the last annual report due on time.
 - In the Public Procurement Act oblige the contractor to require or tenderer to confirm that the tenderer, as at the time of submitting the tender, has submitted the last annual report due on time.

- Withhold the value-added tax refund to legal persons who, at the time of applying the refund, have not submitted the last annual report due on time, until the report has been submitted.
- Apply other restrictions to the activities of legal persons who have failed to submit their annual report on time. For example, restricting the opportunities to carry out registry operations in the Road Administration, losing the protection of the company name, turning the legal person inactive (cannot make operations in the Company Registration Portal).
- Consider possibilities of giving the submission and monitoring of annual reports over to the Tax and Customs Board.

At the same time, we suggest that in parallel with more active use of preventive measures, the use and efficiency of punitive measures should be improved:

1. Send a warning reminder by e-mail to all those legal persons who have failed to submit the report 14 calendar days after the annual report submission deadline. This reminder conveys a message that if the report is not submitted within the following month or the non-submission is not clarified, an automatic fine to the legal person will follow.
2. 1.5 months after the annual report submission deadline fine automatically, in the minimum amount of 200 euros, the legal person who has not submitted the annual report, received a warning reminder and who has not clarified the non-submission.
3. If within 1 month from fining the legal person the annual report has not been submitted, then send an automatic warning reminder by e-mail to the members of the legal person's management board. The reminder conveys a message that if the report is not submitted within the following month or the non-submission is not clarified, an automatic fine to the members of the management board will follow.
4. 3.5 months after the annual report submission deadline fine automatically, in the minimum amount of 200 euros, the members of the legal person's management board if the annual report has not been submitted after the previous warning and the non-submission has not been clarified. In parallel with fining the members of the management board a warning is issued to the legal person and members of its management board stating that a failure to submit an annual report within the following 3 months will be followed by the deletion of the legal person from the registry.
5. 6.5 months after the annual report submission deadline issue a notice of the non-submission of the annual report in Official Announcements (if the legal person has not submitted the report and has not clarified its non-submission) and call the creditors to announce their claims against the legal person and apply for the liquidation within 3 months.
6. If 9.5 months following the annual report submission deadline the liquidation procedure has not been initiated, the annual report has not been submitted and its non-submission has not been clarified, the deletion order is made and this order takes effect 30 calendar days from its issuance.

The modifications listed above require revision of the existing processes and legal framework. The aim should be to enforce monetary sanctions as automatically as possible. That would allow to significantly reduce the costs related to the enforcement of the sanction and would enable to reach more non-filer and late-filers. If the needed solutions cannot be implemented immediately, then till their implementation, solutions should be sought to improve the effectiveness of monetary sanctions within the existing framework. If, after the above-mentioned modifications, the results remain unsatisfactory, then we recommend tightening the fine mechanism, e.g. by issuing automatic fines from the first date of the delayed submission.

While carrying out the analysis, we identified several possibilities for designing a more efficient reporting environment, including improving the user interface of the Company Registration Portal and possibilities for legal improvements. These are described in greater detail in the full final report available in Estonian and would also enable to ensure that the quality of annual reports remains intact following the introduction of new measures. Additionally, we recommend tightening the co-operation between the Ministry of Finance and Ministry of Justice when creating a legal framework and a more efficient reporting environment. The proposals made in the course of the revision of the corporate law would require more thorough legal analysis and discussions with the users of annual reports before their realisation in legal acts. This would allow mapping the current requirements contained in different laws and the proposed changes to the requirements for the preparation, submission and publication of annual reports by type of legal entity. The latter would allow to evaluate which changes would help to create a reporting environment that would be understandable to all parties, could be monitored and would fulfil the public interests.