

Financial Reporting Reform and Choices Made by Smaller Entities

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Abstract

The way in which little GAAP has emerged in the UK suggests that policy makers have taken an arbitrary and piecemeal approach to reform, and this is reflected in the number of changes to disclosure requirements and the frequency with which qualifying size thresholds are revised. This seems surprising, since the accounting profession has spent almost a decade in developing a conceptual framework for financial reporting. The government's rationale for regulatory relaxation for smaller entities is based on reducing the cost burden, rather than any theoretical considerations. Moreover, reforms are being made without evidence of the needs of the directors of small companies, who are the main users of the accounts.

The aim of this study, which was supported by the ICAEW, is to provide generalisable evidence of the utility of the statutory financial statements of small companies to the directors. It took the form of a postal questionnaire survey of the directors of a tranche of 385 companies that are most likely to be affected by proposals to lift the size thresholds that qualify companies to apply little GAAP. This paper focuses on current and likely future financial reporting practices and the reasons for them, as well as providing insights into the main costs and benefits of financial reporting.

The results show that there is a range of reasons for the financial reporting choices made and that the accountant plays an important role in influencing the decision in connection with the type of accounts filed and whether to adopt the FRSSE. However, professional advice plays a minor role with regard to the audit decision: the majority of respondents have already decided that they will continue to have their accounts audited if they become exempt. The main benefit of financial reporting is seen as the confirmation and verification of the annual results, whilst the main disadvantage was identified as the cost and inconvenience. These results should be of interest to policy makers and the accountancy profession alike.

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1. Introduction

This study is set within the context of the current deregulatory trend in financial reporting by small companies in the UK and was supported by the ICAEW. The key elements of the regulatory framework for corporate financial reporting (UK GAAP) are company legislation, accounting standards and the pronouncements of the Urgent Issues Task Force (UITF), and Stock Exchange Listing Rules (for listed companies only). The Companies Act 1985 (as amended by the Companies Act 1989 and subsequent statutory instruments) lays down the broad requirements and format of the financial information that must be disclosed and the details of how and what should be disclosed are contained in the accounting standards.

For historical reasons, UK GAAP has evolved with the needs of large, public companies in mind, but since the 1980s the importance of the role played by small businesses in the economy has increased. Indeed, 99% of the business stock and 96% of companies have fewer than 50 employees and are therefore classified by the government for statistical purposes as small (SBS, 2000, analysis of Table 22, p. 108).

This change of emphasis led to an escalation of the bit GAAP/little GAAP debate. This debate is concerned with the question of whether it is necessary for small companies to be subject to the same extensive range of reporting requirements that govern large (often multinational) public companies and whether small companies should be exempt from some aspects of GAAP on the grounds of size and relative lack of public interest in their financial statements. The main difficulty is determining 'the criteria that should be used to exempt companies as well as widespread concern that accounts that do not comply with accounting standards would not present a true and fair view of the company's activities' (Hussey, 1999, p. 222).

The result of the debate has been the gradual emergence of little GAAP, which consists of certain concessions and exemptions for smaller entities. The principal aim of the government in reforming the legal elements of the regulatory framework to develop little GAAP is to relieve the burden of compliance, which falls disproportionately on small businesses compared to their larger counterparts (DTI, 1995). Thus, the changes are aimed at reducing costs, rather than theoretical assumptions. Moreover, they are being made without evidence of the needs of the directors of small companies, who are the main users of the accounts (Carsberg, Page, Sindall and Waring, 1985).

The purpose of the present research is to provide generalisable evidence of the utility of the statutory financial statements of small companies to the directors in the context of emerging little GAAP. This paper is drawn from a larger project and focuses on current and future reporting practices, and perceptions of the advantages and disadvantages of financial reporting. The research took the form of a postal questionnaire survey in 1999 of a representative sample of private limited companies with a turnover of up to £4.2m, a balance sheet total of up to £2.1m and up to 50 employees. This ensured that the sample included companies that fell within the definition of 'small' under UK law, as well as those that would be reclassified as 'small' if thresholds were raised to the EU maxima at that time.

The next section of this paper provides the background to the study by examining the development of little GAAP as it applies to small companies.¹ This is followed by a description of the methodology. The results are presented and discussed in the fourth section and the paper ends by drawing conclusions.

2. The development of little GAAP

Prior to the Companies Act 1981, all corporate entities, irrespective of their size, the industry they operated in or the public's interest in them, were broadly governed by identical financial reporting requirements. In recent years, however, there have been rapid and widespread developments as a result of the adoption of the provisions of the European Commission (EC) Fourth and Seventh Company Law Directives in the UK, which allow the disclosure requirements for companies of different sizes to be varied.

2.1 Company legislation

2.1.1 Exemptions from statutory disclosure

It was the Companies Act 1981 that first distinguished small and medium-sized companies and permitted them to file modified accounts with the Registrar of Companies; they were still required to prepare full accounts for shareholders. The Companies Act 1985, which consolidated the 1981 Act and was amended by the 1989 Act, introduced other changes. These included revised terminology and the Act now refers to 'abbreviated' rather than 'modified' financial statements.

Under the Companies Act 1985 a company may qualify as small if it satisfies certain size tests and meets other qualification criteria (banking companies, insurance companies and authorised persons under the Financial Services Act 1986 are excluded on the grounds of public interest). As far as size is concerned, the qualifying conditions are met by a company if it does not exceed two or more of the criteria shown for the UK Table 1 in relation to the financial year concerned and the preceding year. The table also shows the EU maxima in force in 1999 (when the study was conducted) and the most recent EU thresholds which the government proposes are adopted by the UK (DTI, 1999a).

Table 1: Size thresholds for small companies

	UK maxima	EU maxima at the time of the study	Present EU maxima
Annual turnover	£2.8m	£4.2m	£4.8m
Balance sheet total	£1.4m	£2.1m	£2.4m
Average number of employees	50	50	50

In 1997 the DTI amended the Companies Act 1985 (SI 1997/220) by introducing a revised Schedule 8 and a new Schedule 8A, which set out in full the provisions of

¹ This discussion is limited to the various simplifications and exemptions from compliance with the mainstream regulations that are offered to eligible small companies, although some concessions are also available to medium-sized companies.

Schedule 4 that apply to small companies. Under the provisions, a small company may choose to file full or abbreviated accounts with the Registrar of Companies, but must provide full financial statements for shareholders. A small company choosing to file abbreviated financial statements is not required to file a profit and loss account or a directors' report and may file an abbreviated or a shorter-form² balance sheet and notes thereto.

Under section 246(3) (b) of the Companies Act (inserted by SI 1997/220 and amended by SI 1997/570), a small company's privacy is protected by not having to disclose certain information from the notes to the accounts. In particular, information from Schedule 6 regarding directors' emoluments can be omitted: the numbers of directors exercising share options and receiving shares under long-term incentives schemes; details of the highest paid director's remuneration; details of directors' and past directors' excess retirement benefits.

Abbreviated accounts must be accompanied by a special auditors' report, unless the company is exempt from the requirement for an audit by virtue of sections 249A(1) or (2) or section 250 of the Companies Act 1985 (see below). This report must state that in the auditors' opinion the company is entitled to deliver abbreviated financial statements and that the statements are properly prepared in accordance with the relevant sections of the Companies Act.

2.1.2 Audit exemption

The EC Fourth Directive permitted national governments to dispense with the requirement for small companies to undergo an audit. This prompted the government in 1994 to amend section 249A of the Companies Act 1985 (SI 1994/1935) to exempt companies with an annual turnover of up to £90,000 and a balance sheet total of up to £1.4m. Companies with a turnover of between £90,000 and £350,000 were given the option of filing a simpler audit exemption report in place of the full audit report. Following the publication of a consultation document (DTI, 1997), the audit turnover threshold was revised to £350,000 (SI 1997/936), thereby removing the statutory requirement for the audit exemption report.

In 1999 the DTI announced proposals to raise the thresholds again, possibly up to the maximum levels set by the EU (DTI, 1999b).³ The rationale for this increase focuses mainly on potential cost savings for increased numbers of small companies. It is difficult to estimate how many companies would be affected by such a change. There are some 380,000 companies that file abbreviated accounts and since such accounts do not include turnover figures it is not possible to calculate how many of them fall within the current or proposed exemption levels (DTI, 1999c). Based on the accounts of 750,000 companies at Companies House where the turnover data is available, the DTI estimates that 520,000 (69%) are currently within the exemption threshold, and that lifting the level to £4.2m

² 'Shorter-form' is used to refer to the individual or group financial statements small companies are permitted to prepare for shareholders by virtue of section 246(2)-(4) of the Companies Act 1985.

³ In most EU countries the threshold is substantially higher than in the UK (typically, £2m-£4m), but there are also legal and regulatory differences, as well as variations in the company populations and size distributions. These factors make inter-country comparisons problematic.

would increase the number by 185,000 to 705,000 (94%). In addition, an estimated 90,000 companies that currently file abbreviated accounts would be able to opt out if the threshold was raised to the maximum. This would bring the total number of companies to approximately 795,000 (DTI, 1999c, pp. 5-6).

Following a period of consultation, in 2000 a two-stage increase in the threshold was announced. The first stage was to raise the threshold to £1m followed by a further increase to the maximum EU level to be made in the light of the Company Law Review's final proposals on the accounts and audit of small companies. This would include consideration of whether some less burdensome form of assurance should be required for companies with a turnover of between £1m and £4.8m (DTI, 2000).

Exemption from the audit removes the need for the directors to engage an independent, professionally qualified and regulated person. To some extent, minority shareholders, who might not otherwise be able to obtain accounts with any external assurance, are protected by provisions that allow for an audit if it is required by at least 10% of the shareholders.

2.1.3 Review of company law

In 1998 the DTI launched a fundamental review of core company law and one of the key issues in the consultation document is that the law should recognise that the vast majority of companies are small or medium-sized by adopting a 'think small first' approach (DTI, 1999d). The Review puts forward a number of measures 'to reduce the burden of financial reporting and audit while improving the usefulness of small company accounts' (DTI, 2001, p. 3). A major recommendation is that the format and contents of small company accounts should be simplified and small companies should no longer be able to file what are referred to as 'uninformative' abbreviated accounts. The Review also recommends that the size thresholds for companies able to use the small company accounting regime should be raised to the maximum allowed under EU law (see Table 1). Thresholds for exemption from the audit should be raised in the same way.

2.2 Accounting standards

Although the issue of accounting standards and small entities was considered by the ASC in 1983, it was not until five years later that a statement on the application of accounting standards to small companies was published (ASC, 1988). The next development was in November 1994 when a working party of the Consultative Committee of Accountancy Bodies (CCAB) was set up at the request of the ASB to carry out a consultation exercise to assess whether companies should be exempted from compliance with accounting standards on the grounds of size or public interest. The working party concluded that the needs of the 'less complex entities and those who deal with them would be best served by straightforward, uncomplicated accounts and that some of the requirements of accounting standards tend to conflict with these needs' (CCAB, 1994, p. 15).

The result of the consultation showed clear support for some relief based on size, or a combination of size and public interest, and the working party recommended the promulgation of a specific financial reporting standard for smaller entities (CCAB, 1995).

Accordingly, the ASB published an exposure draft (ASB, 1996) and subsequently issued the Financial Reporting Standard for Smaller Entities (FRSSE) (ASB, 1997 and subsequent revisions). The FRSSE is applicable to all reporting entities that qualify as small under the Companies Act 1985 and collects together in one document, and in simplified form, the accounting standards and other requirements for preparing and presenting the financial statements of smaller businesses.

If the entities within its scope choose to adopt the FRSSE, they become exempt from applying all other accounting standards and UITF abstracts. Alternatively, they can choose not to adopt it and remain subject to the full range of accounting standards and UITF abstracts. The measurement bases in the FRSSE are the same as, or a simplification of, those in existing accounting standards, and the definitions and accounting treatments are consistent with the requirements of company legislation. The disclosure requirements exclude a number of those stipulated in other accounting standards⁴.

3. Methodology

The study took the form of a large postal questionnaire survey following an exploratory study.⁵ The sample companies were selected from FAME, which contains information on 270,000 British companies taken from the returns made to the Registrar of Companies. One limitation of this choice is that the database does not include many companies with a turnover of under £0.5m.⁶ However, the information is detailed, up to date and easy to access. A search of the database was conducted at the beginning of March 1999 to identify all active, independent,⁷ private limited companies that met the following size criteria⁸ in the most recent year for which accounts were filed:

- turnover of up to £4.2m (information available for 46% of companies on FAME as only companies filing full accounts disclose this figure);
- balance sheet total of up to £2.1m (information available for 100% of companies on FAME);
- number of employees of up to 50 (information available for 32% of companies on FAME).

These search criteria provided a list of 11,648 companies filing full, audited accounts (£350,000 turnover being the audit exemption level at the time of selection). The list was sorted alphabetically and a systematic random sample taken by selecting every fifth company. This gave an initial list of 2,327 companies, from which 39 were later eliminated as they were outside the scope of the study, which reduced the list to 2,288. After two follow-ups, a total of 385 usable replies were received, giving a response rate of 17% and sufficient to allow the results to be generalised from the sample to the population.⁹

⁴ The FRSSE is updated annually to take account of amendments to accounting standards.

⁵ The results of the exploratory study were subsequently published (Collis, Dugdale and Jarvis, 2001).

⁶ Therefore the sample is not representative of companies below this level.

⁷ Subsidiary companies were excluded.

⁸ These are the maximum levels under EU law at the time the companies were selected.

⁹ According to Krejcie and Morgan (1970, p. 608), for populations of 1m or more, the minimum acceptable sample size is 384.

In any large survey the problem of questionnaire non-response bias must be addressed, since it is not likely that all those surveyed will respond. Previous research (Morgan, 1974; Wallace and Mellor, 1988) suggests that non-respondents behave like late respondents. Therefore, one method for testing for non-response bias is to compare the characteristics of the respondents to the first mailing with those who reply to the second request. This was done by conducting an independent samples *t* test to look for differences in the mean age, turnover, total assets, number of employees and number of shareholders of the two batches of respondents. The results were non-significant in each case, confirming that there was no difference between early and later respondents and that the findings of the study can be generalised to the wider population of similar companies.

4. Results and discussion

4.1 The sample companies

Table 2 shows a breakdown of the sample companies by size.

Table 2: Companies by size

Criteria	No. of companies	% of companies
Turnover		
Under £1m	238	62
£1.0m – £1.99m	72	19
£2.0m – £2.99m	38	10
£3.0m – £3.99m	32	8
£4.0m - £4.2m	5	1
Total assets		
Under £0.5m	187	49
£0.5m – £0.99m	93	24
£1.0m – £1.99m	96	25
£2.0m – £2.1m	9	2
Employees		
Up to 10	199	52
11 – 20	94	24
21 – 30	41	11
31 – 40	30	8
41 – 50	21	5

N = 385
Source: FAME

The table illustrates that even though the sample was not representative of companies with a turnover of less than £0.5m at the time of selection, the majority of small companies are concentrated at the lower end of the spectrum in terms of all three size criteria

4.2 Filing choice

The filing options set out in the Companies Act 1985 allow companies that qualify as small to prepare and file either full or abbreviated financial statements with the Registrar of Companies. At the time of selection, the most recent accounts filed by the sample companies were full accounts and the next table shows that nearly a third had filed abbreviated account the previous year.¹⁰

Table 3: Filing choice last year

Filing choice	No. of companies	% of companies
Full accounts	252	65
Abbreviated accounts	114	30
Uncertain/no response	19	5
Total	385	100

As private companies can file their accounts with the Registrar up to 10 months after the end of their accounting reference period, it is difficult to be certain whether this result reflects a switch from filing full accounts to abbreviated account or vice versa. Moreover, the variation may be due to a change in preference on the part of the directors or a change in eligibility due to size factors. Indeed, some respondents volunteered that they had only recently exercised the choice to file abbreviated accounts or had become eligible to do so.¹¹ A test of association found that companies filing abbreviated accounts are more likely to have a turnover of under £1m and those filing full accounts tend to have a turnover of £1m or more (chi-square 6.766; degrees of freedom 1; $p < 0.01$).

The respondents were asked to state the main reason for their filing choice. This was designed as an open question and the results have been derived from classifying the replies. Table 4 shows the reasons given by the 207 respondents answering this question.

Table 4: Reason for filing full accounts

Reason	No. of companies	% of companies
To meet statutory requirements	62	30
On the advice of our accountant	56	27
We've always filed full accounts	30	15
We want to make full disclosure	25	12
There are cost benefits	13	6
Other	21	10

¹⁰ Using the size thresholds in the Companies Act 1985, 31% of small companies and 22% of medium-sized companies in the sample had filed abbreviated accounts.

¹¹ Four of the sample companies had primary activities in the banking, finance, insurance, business services and leasing sector and may not have qualified for the exemptions and concessions available on the grounds of public interest.

The most commonly cited reason, reported by 30% of respondents, is that the directors are merely complying with statutory requirements. Without further investigation it is difficult to know whether some companies are unaware that they might have filed abbreviated accounts or that they were not eligible to file abbreviated financial statements in that period.

More than a quarter of those filing full accounts stated that they did so because they were following their accountant's advice. It seems likely that the directors of small companies would rely on professional advice when it comes to meeting their obligations in such a complex and heavily regulated area as financial reporting. The survey found that 31% of the companies had a qualified accountant on the board of directors or on the staff, so accountancy advice would have been readily available for these firms.

There may have been a number of reasons for advising full disclosure, the most important of which hinge on the question of the company's eligibility to file abbreviated accounts. The application of the criteria for defining small and medium-sized companies can be complex. In addition to satisfying the basic size tests, companies must also satisfy other qualification criteria, which may be difficult to interpret. It could be that some accountants are erring on the safe side in advising full disclosure. However, it seems more likely that, if there is no need to protect commercial confidentiality, filing full accounts would avoid the cost of preparing abbreviated accounts.

In other cases the advice to file full accounts may be connected to commercial benefits of full disclosure, a reason given by 12%. This would be important if the directors were planning a flotation or other form of external investment (Olsson, 1980) or to enhance their corporate image (Korn Ferry, 1986; Martin, 1989). Indeed, one respondent mentioned that his company filed full accounts because in his opinion, "It looks more professional". The table shows that 15% of the sample companies had filed full accounts because they had always done so. One executive chairman explained, "We want to show the growth and performance of the company and that we've got nothing to hide". The cost benefits of filing full accounts were cited by fewer than 10% of respondents.

Table 5 shows the reasons given by the respondents of the 102 companies that had filed abbreviated financial statements in the previous financial year.

Table 5: Reason for filing abbreviated accounts

Reason	No. of companies	% of companies
It's the legal minimum/to protect confidentiality	43	42
On the advice of our accountant's advice	22	23
There are cost benefits	18	17
We are permitted to do so	17	16
Other	2	2
Total	102	100

It is widely acknowledged that, regardless of size, one of the aims of management is to comply with regulatory requirements with the minimum disclosure of information that would be of advantage to a competitor (Mace, 1977; Hussey and Everitt, 1991). This was reflected in the most common reason for filing abbreviated accounts cited by 42%. As one respondent stated, “We’ve got something to hide!” Acting on their accountant’s advice was given as a reason by 22% and cost benefits were given by 18%. This might be interpreted as indicating that some directors consider that there are cost advantages in preserving commercial confidentiality, but requires further investigation.

4.2 The statutory audit

In the light of proposals to increase the audit exemption level, the respondents were asked how useful they find the auditors’ report on their own company’s accounts using a rating scale where 1 = of no use and 5 = very useful. If the midpoint of the scale is considered to be neutral, grouping together the results into two categories of useful and not useful, reveals that 42% of the directors find the auditors’ report useful, compared with 40% who do not. Their views on the statutory audit were probed further by asking whether they would continue to have their accounts audited if they were not legally required to do so. Table 6 gives details.

Table 6: Views on a non-mandatory audit

View	No. of companies	% of companies
Would continue to have accounts audited	241	63
Would not have accounts audited	111	29
Would take professional advice	21	5
Undecided	11	3
No response	1	<1
Total	385	100

These results show that 63% of companies would continue to have their accounts audited if they were exempt and the main reason they gave were the value they placed on having an independent check on the figures and/or confirmation of the financial position. The main reasons given by the 29% who would discontinue having their accounts audited were the savings in time and/or expense and the view that there was little or no benefit in the audit. As one managing director noted, “... we keep very tight controls and find that the auditors simply feed back information we have already prepared.”

Size was found to be a significant factor in the audit decision (t 3.663; degrees of freedom 350; p <0.01). Those who would have their accounts audited voluntarily had an average turnover of £1.3m, whilst those who would stop doing so had an average turnover of £0.8m. The factors that drive the demand for the audit are explored in Collis, Jarvis and Skerratt (2001).

4.3 The FRSSE

The FRSSE represents the most recent development in the deregulatory trend for small companies, but it is worth noting that if abbreviated accounts are filed, adoption of the FRSSE will make little difference to the amount of information disclosed to external parties. In order to gain some insights into the views of owner-managers on the standard, the respondents were asked whether the company would be preparing its statutory annual accounts in accordance with the FRSSE. Although this was a somewhat technical question to expect the respondents to answer, it was considered likely that their accountants would have discussed the options with them. Table 6 shows their responses.

Table 7: Adoption of the FRSSE

Adopt the FRSSE	No. of companies	% of companies
Will take professional advice	240	62
Undecided	44	12
No	43	11
Yes	38	10
No response	20	5
Total	385	100

The table reveals that the majority of owner-managers will take professional advice before deciding whether to prepare their accounts in accordance with the FRSSE with a further 12% undecided. Nevertheless, nearly a quarter had made up their minds, with 11% deciding against adoption and 10% in favour.

Of the 32 respondents who gave reasons for not adopting the FRSSE, the main reason (given by 12 respondents) can be summed up by the managing director who wrote, “We have no wish to change”. The remainder gave a range of different reasons and 8 respondents acknowledged that they did not know what it was. This finding is understandable and is supported by qualitative research conducted around the same time with the profession (John and Healeas, 2000).

The importance of the accountant’s advice was highlighted in the responses given by 9 of the 26 respondents who gave reasons for adopting the standard. This is substantiated by a survey of members of the profession (ACCA, 2000), which suggests that 67% of their eligible clients have adopted the FRSSE, which implies that the profession is in favour of this particular development of little GAAP.

There was no significant association between size of company and the respondents’ views on adopting the FRSSE.

4.4 Advantages and disadvantages of financial reporting

This section reports on the results relating to the directors’ opinions on the general advantages and disadvantages of financial reporting. The questions on this topic were designed as open-ended questions in order to elicit the widest range of undirected

answers. This type of question can be successful if respondents identify fairly strongly with the objectives of the research or have strong feelings on the topic (Kervin, 1992).

Table 8 shows the result of categorising the responses relating to the main advantage of having to produce the statutory annual accounts.

Table 8: Main advantage of financial reporting

Main advantage	No. of companies	% of companies
Confirmation/verification	122	32
Annual update/overview	59	15
Discipline/good practice	44	11
Other advantage	75	20
Little/no advantage	43	11
No response	42	12
Total	385	100

The majority of respondents (78%) consider that there is some advantage to be gained from having to produce the statutory annual accounts. The principal benefit appears to lie in having the financial results confirmed or verified, with nearly one-third of respondents holding this view. This implies that the accountants who prepare and audit the accounts are perceived as experts and give credibility to the results. A second related advantage is the benefit of having an annual update or overview of the financial position. This supports the findings of previous research: ‘The directors seem to have a rough idea of the results of the business over a period, but find the annual accounts useful in dispelling the uncertainty about profitability’ (Carsberg *et al*, 1985, p. 31). A test of association found a positive correlation between size of company and the perceived advantages of having to produce the statutory accounts. Companies with a turnover of £1m or more are likely to consider that the main advantage is the confirmation/verification of the results compared with companies under this level (chi-square 11.688; degrees of freedom 4; p 0.02).

Table 9 shows the results of categorising the views of the respondents on the main disadvantage of having to produce the statutory annual accounts. It must be borne in mind that the results shown in Tables 8 and 9 are not mutually exclusive.

Table 9: Main disadvantage of financial reporting

Main disadvantage	No. of companies	% of companies
Cost/time/inconvenience	249	65
Other disadvantage	29	7
Little/no disadvantage	46	12
No response	61	16
Total	385	100

A total of 72% of respondents consider there is some disadvantage in having to produce

the statutory annual accounts. The main disadvantage is considered to be the cost, financially or in terms of time and inconvenience. However, 12% specifically stated that they do consider there is little or no disadvantage in producing the statutory accounts. Both this table and the last demonstrate that the directors consider there are both costs and benefits in meeting regulatory requirements. Significant association was found between size and perceptions of the main disadvantage of financial reporting. Companies with a turnover of under £1m tended to consider that the main disadvantage was the cost and inconvenience, whilst those with a turnover £1m or more were more likely to hold other views or be of the opinion that there were few or no disadvantages to producing the statutory accounts (chi-square 7.987; degrees of freedom 2; p 0.02).

It is interesting that the disclosure of information that may be useful to competitors was not considered to be a disadvantage by sufficient numbers of respondents to feature as one of the categories in the table. This lack of emphasis placed on commercial confidentiality contrasts with the results in Table 7.3, which show that the main reason given by those who had filed abbreviated accounts the previous year was to disclose the legal minimum. In both cases, the responses analysed resulted from an open question without prompts, but it would appear that in the general context of little GAAP reporting, the directors of small companies do not see the disclosure of financial information as a burden. This confirms previous research by Carsberg *et al* (1985), which was conducted prior to the introduction of the option for small companies to reduce disclosure.

5. Conclusions

The way in which little GAAP has emerged in the UK suggests that policy makers have taken an arbitrary and piecemeal approach to reform. This is reflected in the number of changes to disclosure requirements and also the frequency with which the size thresholds for identifying qualifying companies are revised upwards. This is surprising, since the accounting profession has spent almost a decade in developing a conceptual framework for financial reporting. The government's rationale for the current deregulatory trend is based on reducing the cost of financial reporting by small companies and little attention has been given to any benefits. Moreover, reforms are being made without generalisable empirical evidence of how the complete raft of changes in the emerging little GAAP is being received by the main users of the statutory accounts, the directors of small companies themselves. This is a serious omission and at odds the government's views on evidence based policy making (Cabinet Office, 1999).

This study addresses some of the deficiencies in the literature and focuses on a tranche of companies that are most likely to be affected by proposals to lift the size thresholds that qualify companies to apply little GAAP. At the time of selection, all the sample companies had filed full accounts, but the survey reveals that in the previous accounting period 30% had filed abbreviated accounts. This choice was influenced by the need to fulfil their statutory obligations or because the directors were following the advice of their accountant. The main reasons given for filing abbreviated accounts were because they wished to disclose the legal minimum and/or preserve commercial confidentiality. Whether they choose to file full or abbreviated accounts, a significant proportion of owner-managers do so on their accountant's advice.

This is not surprising since practitioners are in the best position to offer guidance in such a highly regulated environment. A key factor in the filing decision is the company's eligibility to file abbreviated accounts. In addition to satisfying the basic size tests, companies must also satisfy other qualification criteria, which may be difficult to interpret and therefore require professional advice. A second important factor is that the accountant knows the client's business and can therefore discuss with the owner-manager the pros and cons of filing abbreviated accounts which protect commercial confidentiality but incur higher costs since they must be prepared in addition to the full accounts for shareholders. Nevertheless, the cost benefits of filing full accounts were highlighted by 6% of respondents. However, cost benefits were cited as reasons for filing both full accounts and abbreviated accounts, which requires further investigation.

It would appear that the accountant has an important role to play, not only in advising on the type of accounts that should be filed, but also in whether the accounts will be prepared according to the FRSSE. The majority of respondents were undecided and 62% stated that they would be taking professional advice. However, professional advice plays a minor role in connection with the audit and the majority of respondents (63%) had made up their minds that they would continue to have their accounts audited even if they became exempt.

The directors of small companies perceive both costs and benefits to financial reporting. The main advantage is seen as the confirmation/verification of the financial results, and this opinion tended to be held by the owner-managers of companies with a turnover of £1m or more. The main disadvantage was seen as the cost and inconvenience and this view was more likely to be held by the directors of companies with a turnover of less than £1m. Contrary to the findings of previous research (Keasey and Short, 1990) this indicates that size does influence the perception of the relative burden of financial reporting requirements. The importance of perceived benefits of financial reporting in addition to costs should be built into future models of reform and this finding should be of interest both to the accountancy profession and the regulators.

Financial reporting reform and choices made by smaller entities

[I'm not sure if this title fully reflects the purpose and direction of the paper]

This is my proposed conclusion - the previous conclusion tended to summarise and repeat the findings in our results section.

This study, in the context of the development of little GAAP, identifies and examines a number of issues relating to the utilisation of statutory financial statements by the directors of small companies. Through this process a number of the deficiencies in the literature are addressed, the perspective of the regulator is questioned and the importance of the accountant is identified in the selection of options available to small companies by the regulations within the little GAAP framework.

Directors of small companies recognise that there are benefits and costs associated with

producing statutory financial statements. This is particularly reflected, in the study, in their choice of having financial reports audited. It was found that the majority of companies with a turnover of more than £1m would continue to have an audit even if they were exempt. This clearly establishes that the size of the company is important in terms of the relationship between the cost and benefits of producing financial statements. In contrast, previous research (Keasey and Short, 1990) indicated that size did not influence the perception of the relative burden of financial reporting requirements.

Regulators and particularly the government have tended to focus on reducing costs of financial reporting of small companies and have given little attention to any benefits. This unbalanced approach to regulation, if unchecked, could result in the introduction of new regulations having a negative impact on the small business community which it is trying to support. Moreover, reforms are being made without generalisable empirical evidence. This is a serious omission and at odds with the government's views on evidence based policy making (Cabinet Office, 1999).

It was perhaps surprising to find that 31% of the sample small companies had a qualified accountant on the board of directors or on the staff. However, the findings indicate that they and the external accountants play a significant role in the decisions relating to choices on whether to elect to file abbreviated accounts rather than full accounts and the decision on whether to adopt the FRSSE. The findings also suggest that these decisions are very complex and it is unlikely that the non accounting directors would be able to make informed decision of this nature. The implications of this is that in researching the possible changes in regulations to financial reporting of small companies, prior to their introduction, the company's accountant or external accountants should be consulted rather than the non accounting directors.

Future steps in decreasing the burden of financial reporting of small companies must therefore be cautiously taken whilst recognising the importance of the quality of the information content and its utility to the small company in the management of the enterprise.

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