

**DIRECTORS' VIEWS ON
ACCOUNTING AND AUDITING
REQUIREMENTS FOR SMES**

Dr Jill Collis

April 2008 (minor updates at November 2008)

In association with

Kingston University London

Acknowledgements

I am greatly indebted to all those who participated in this study. Some gave up their valuable time to be interviewed as part of the testing of the questionnaire and others kindly completed and returned the questionnaire. Without your help, this updating of our knowledge of the financial reporting needs and practices of SMEs in a changing regulatory environment would not be possible. Thank you very much for contributing to this survey.

Contents

	<i>Page</i>
List of tables	4
Executive summary	6
1. Background to the study	13
Introduction	13
Purpose	13
Structure of the report	14
2. Accounting and auditing requirements for SMEs	15
Introduction	15
Statutory accounts	16
Financial Reporting Standard for Smaller Entities	17
International Financial Reporting Standard for SMEs	17
Statutory audit	18
Proposed EU simplifications	19
3. Methodology	21
Introduction	21
Sample selection	21
Data collection	22
Data analysis	23
Generalisability	23
Comparison with the 2003 study	24
4. The sample companies	26
Introduction	26
Ownership, size and age	26
Key financial indicators	29
External sources of finance	30
Services from external accountant(s)	31

	<i>Page</i>
5. Accounting	33
Introduction	33
Filing decision	33
Users of the published accounts	34
Filing exemption for micro entities	36
Financial Reporting Standard for Smaller Entities	37
International Financial Reporting Standard for SMEs	37
Transition period for SMEs	38
6. Auditing	39
Introduction	39
Perceptions of the audit	39
Audit decision	39
Audit costs	41
Auditor independence	42
Predicted audit decision	43
Audit exemption for medium companies	43
Alternative form of assurance	44
7. Longitudinal analysis	45
Introduction	45
Companies in the analysis	45
Accounting	49
Auditing	51
8. Discussion and conclusions	53
Evaluation of the research design	53
Main accounting results	54
Main auditing results	55
Contribution of the study	57
References	58
<i>Appendix 1 – UK accounts exemption thresholds from 2008</i>	61
<i>Appendix 2 – The questionnaire</i>	64

List of tables

	<i>Page</i>
2.1 UK thresholds for small and medium entities from April 2008	16
2.2 UK thresholds for abbreviated accounts 1981 - 2008	17
2.3 UK thresholds for total audit exemption 1994 - 2008	18
3.1 Distribution by industry	22
3.2 Descriptive statistics for size variables	24
3.3 Comparison of the size selection criteria for the two studies	25
4.1 Turnover in 2006	27
4.2 Balance sheet total in 2006	27
4.3 Average employees in 2006	28
4.4 Age in 2006	28
4.5 Spearman's correlation matrix for ownership, size and age	29
4.6 Key financial indicators in 2006	30
4.7 Spearman's correlation matrix for age, size and financial indicators	30
4.8 External sources of finance in 2006	31
4.9 Services from external accountant(s) in 2006	32
5.1 Filing decision in 2006	33
5.2 Factors affecting the filing decision in 2006	34
5.3 Recipients of the 2006 accounts	34
5.4 Users of the published accounts	35
5.5 Time lag from year-end to receipt of accounts in 2006	36
5.6 Filing exemption for micro entities	36
5.7 Use of the FRSSE by small companies for the 2006 accounts	37
5.8 Advantageous to use the IFRS for SMEs (Private Entities)	38
5.9 Increase the transition period to five years	38
6.1 Perceptions of the audit	39
6.2 Audit decision by small companies in 2006	40
6.3 Factors affecting the audit decision in 2006	40
6.4 Auditing and filing decisions by small companies in 2006	41
6.5 Audit fees in 2006	41
6.6 Effect on total accountancy fees on discontinuing the audit	42
6.7 Auditor independence in 2006	43
6.8 Predicted audit decision	43
6.9 Predicted audit decision by owner-managed medium companies	44
6.10 Interest in an alternative form of assurance	45

	<i>Page</i>
7.1 Distribution by industry	46
7.2 Turnover in 2002 and 2006	46
7.3 Balance sheet total in 2002 and 2006	47
7.4 Average employees in 2002 and 2006	47
7.5 Age in 2006	47
7.6 Key financial indicators in 2006	48
7.7 External sources of finance in 2006	48
7.8 Services from external accountant(s) in 2006	49
7.9 Filing decision in 2002 and 2006	49
7.10 Factors affecting the filing decision in 2006	50
7.11 Recipients of the 2006 accounts	50
7.12 Use of the FRSSE in 2002 and 2006	51
7.13 Audit decision in 2002 and 2006	51
7.14 Factors affecting the audit decision in 2006	52
7.15 Predicted audit decision in 2003 and 2007	52

Executive summary

Background to the study

This research was commissioned in August 2007 by the former Department of Trade and Industry (DTI), now the Department of Business, Enterprise and Regulatory Reform, to contribute to strategic priorities in connection with better regulation and reducing administrative burdens within the Corporate and Insolvency Activity Framework. The study focuses on the opinions of the directors of SMEs, who are important because they are the main users of the statutory accounts.

The aims of the research are:

- to investigate the directors' views on present accounting and auditing requirements for SMEs in UK company law and draft simplification proposals made by the European Commission in July 2007
- to identify changes in the financial reporting practices of companies that had participated in a previous study commissioned by the then DTI (Collis, 2003), which focused on issues in connection with raising the audit exemption thresholds.

Accounting and auditing requirements for SMEs

When the financial reporting options for SMEs were first introduced in the UK, the thresholds were set at a lower level than the EU maxima, and the turnover threshold for audit exemption was lower than for the accounting options. Subsequently, the UK raised the thresholds in a series of steps, until in 2004 the levels were standardised for all financial reporting options and harmonised with the EU maxima. In April 2008, the UK thresholds were raised again to align them with the revised EU maxima.

In general, unless excluded for reasons of public interest, an entity qualifies as small or medium in relation to a financial year if it meets two or more of three size criteria relating to turnover, balance sheet total and average number of employees in its first year. In a subsequent financial year, it must qualify or satisfy the size tests in that year and the preceding year. The conditions for exemption from audit are that the entity qualifies as small in relation to that year and meets both the turnover and balance sheet criteria for that year.¹

The financial reporting options for SMEs in the UK can be summarised as follows:

- Qualifying small and medium-sized entities can choose to file abbreviated accounts with the Registrar at Companies House, drawn from the full accounts that must be prepared for shareholders.

¹ The detailed rules can be found in the Companies Act 2006, c. 45, Parts 15 and 16. See Appendix 1 for a summary of the thresholds for companies with accounting periods starting on or after 6 April 2008.

- Qualifying small entities can forgo the statutory audit, unless it is required by shareholders holding at least 10% of issued share capital.
- Qualifying small entities can choose to adopt the *Financial Reporting Standard for Smaller Entities* (FRSSE) in place of the full range of accounting standards.²

In the last three years, there have also been significant developments in connection with the use of International Financial Reporting Standards (IFRS):

- Since 2005, the use of IFRS has been a requirement for all listed groups in the UK and a choice for single listed entities and unlisted entities.
- The draft IFRS for SMEs (Private Entities) is a simplified, self-contained set of accounting principles based on full IFRS, which is being developed for smaller, unlisted companies. It is anticipated that the standard will be issued in 2008, when national governments will have the opportunity to decide whether to adopt it and, if so, to which entities within their jurisdictions it will apply.

In July 2007, the European Commission proposed a number of simplifications to the company law, accounting and auditing directives. Those concerned with reducing burdens on SMEs were:

- to introduce a new category of micro entities
- to exempt micro entities from the scope of the Fourth Directive
- to extend the transition period for SMEs crossing the size thresholds
- to exempt small entities from the requirement to publish their accounts
- to permit some owner-managed medium-sized entities and unlimited companies to use rules that are currently only available to small entities.

Methodology

The research data was collected via a large-scale postal questionnaire survey, preceded by a small number of preliminary interviews to pilot the questionnaire. All companies in the UK and Northern Ireland that had filed their 2006 accounts by the end of August 2007 were selected, apart from those in financial intermediation. The FAME database was used as the sampling frame and the size selection criteria were based on two of the 2008 size tests for a medium company: balance sheet total not exceeding £12.9 million and up to 250 employees.

In September 2007, the questionnaire was sent to a named principal director, together with an explanatory letter and freepost return envelope. Usable replies were received from 1,294 of a list of 9,458 companies within the scope of the study, giving a response rate of 14%. Some size bias was present in the sample, since the sampling frame was not representative of those with a turnover under £0.5 million. Descriptive statistics showed that balance sheet total and average number of employees was slightly larger for the sample than for the population. This means that non-respondents were likely to have been smaller in terms of these two size

² A small group adopting the FRSSE also needs to apply certain other standards.

measures. Therefore, the results of the survey may not be generalisable to the smallest companies.

The sample companies

In 89% of cases, the questionnaire was answered by a director or company secretary and in a further 11% of cases by a manager or accountant. As in the wider population, the majority of the sample were at the smaller end of scale in terms of ownership and size: 77% had between one and four shareholders; 49% were wholly family-owned (only one shareholder or all are related) and a further 23% were partly family owned. Just over half (55%) can be described as owner-managed, since all their shareholders had access to day-to-day internal financial information. In terms of size, approximately 50% had a maximum turnover of £5.6 million, 83% had a maximum balance sheet total of £2.8 million and 59% had up to 50 employees (thresholds for a small company at the time of the study). A quarter of the sample had been incorporated for up to 5 years at the time of their 2006 accounts. Older and larger companies tended to have higher credit rating scores than their smaller counterparts did.

A large proportion of SMEs (83%) were funded by debt finance in 2006 in addition to share capital and retained profit. Directors' loans and/or bank finance were used by at least a third of small companies, but more than half the medium-sized companies used bank finance and/or asset-based finance (hire purchase or leasing).

The vast majority of SMEs (83%) used an external accountant to prepare the 2006 accounts for shareholders, Companies House and the tax authorities. Many companies also received advice on accounting and/or auditing regulations.

Main accounting results

Most of the sample SMEs (68%) had registered full accounts at Companies House in 2006, including 25% whose directors had done so on a voluntary basis. Small companies whose directors had chosen to have a voluntary audit in 2006 were more likely to have filed full accounts on a voluntary basis, rather than take up the option to file abbreviated accounts.

In most cases (60%), the directors knew whether the company had a choice in the type of accounts they registered. The main factor influencing the filing decision was the desire for consistency with previous year (65% agreed), which may account for the relatively small proportion (27%) acknowledging that they had reviewed the costs and benefits since 2003. Cost was a major factor for only 21% of SMEs. Although abbreviated accounts avoid the need to publish turnover data, disclosing turnover was not a factor in the filing decision for 66% of respondents.

The main direct and non-statutory recipients of the statutory accounts are the bank/lenders (67%) and the tax authorities (50%). However, more than half the directors (56%) considered the published accounts are useful to users. The main user groups are creditors (64%), credit rating agencies (62%) and the bank/lenders

(46%). Only 57% of directors thought that competitors were using the published accounts. This may be due to some SMEs having activities in niche markets or operating in locations where there is little or no competition.

A substantial proportion of SMEs (65%) supported the notion put forward by the European Commission that smaller entities might be exempt from the statutory requirement to register accounts. Not surprisingly, this view was significantly associated with small companies rather than medium companies.

The directors of 69% of the small companies in the sample stated they had taken up the option of preparing their accounts using the UK's Financial Reporting Standard for Smaller Entities (FRSSE). However, care must be taken when drawing conclusions, as the directors may not have verified the information they gave.

A quarter of all SMEs considered it would be an advantage to be allowed to prepare their statutory accounts using the International Financial Reporting Standard for SMEs. Size was a significant factor, with the directors of medium companies more likely to consider it a benefit than those of small companies.

Under company law, if a small company exceeds the size thresholds for two consecutive years, it must apply the more stringent accounting and auditing rules for medium-sized companies. More than a third of SMEs (37%) were in favour of extending the transition period to five years and further analysis found these were more likely to be small rather than medium companies.

Main auditing results

The directors perceived the main benefits of having the accounts audited were a check on accounting records and systems (74% agreed), improving internal controls (44% agreed) and the positive effect of the credit rating score (44% agreed). However, 33% of respondents considered the costs outweigh the benefits.

The directors of 54% of the SMEs in the study indicated that the accounts had been audited in 2006 because the company was above the audit exemption thresholds. To provide a basis for the analysis in this study, these companies were categorised as medium-sized and the remaining 46% as small. Audit exemption is only available to small companies.

The main influence on the audit decision in 2006 for both small and medium companies was the desire for consistency with previous years (45% agreed this was a major factor). This may account for only 19% acknowledging they had reviewed the costs and benefits since 2003. Almost half the respondents (45%) knew whether the company had a choice. The audit decision was influenced by the needs of lenders in 44% of companies and by the needs of shareholders in 33% of cases, with strong positive association between these two factors. Cost was a major burden for 22% and this was more likely in small companies than in medium companies.

Not surprisingly, audit fees were likely to be lower in small companies than in medium companies. Among the small companies that reported reduced fees on discontinuing the audit since 2003, the amount saved was typically £5,000 or less. However, 54% of companies that had given up the audit since 2003 reported no change in their total accountancy fees.

Among companies whose 2006 accounts had been audited, 10 years was the typical length of time the current firm had been providing auditing services. In 78% of cases, the auditor was either someone from the same firm that was responsible for preparing the accounts (but not the same person) or someone from a different firm.

The majority of small companies (61%) had not had their 2006 accounts audited. However, 39% had chosen a voluntary audit (mainly for the benefits, but a few because they were close to the thresholds). Among the sample as a whole (ie both small and medium-sized companies), 57% predicted they would have a voluntary audit if they were exempt. Indeed, 58% were against extending exemption to medium sized companies. Among owner-managed medium-sized companies, 73% indicated that they would continue to have an audit. A considerable proportion of SMEs (69%) would be interested in a less rigorous and cheaper form of assurance, and such interest was significantly associated with small companies whose accounts had not been audited in 2006.

Longitudinal analysis

Among the respondents to the present study were 94 companies whose directors had also participated in the previous study (Collis, 2003). This permits a longitudinal analysis that compares their financial reporting choices in their 2002 accounts with those they made in the 2006 accounts. This provides some useful insights into the impact of raising the thresholds in 2004 on this particular group of companies.

It is not possible to compare the percentage results for this group of 94 companies with those in the main part of the report or the previous study, due to the small number of companies in this subset and differences in the selection criteria for the two studies. The 2003 study used the EU maxima for a small company at that time, due to its focus on raising the audit exemption thresholds for small companies. On the other hand, the size limits for the present survey reflect the April 2008 EU maxima for a medium company, because this study investigates wide range of issues that are relevant to both small and medium-sized companies.

Due to the relatively small size of this subset (94 companies), some industrial sectors (SIC codes C, E, M and N) were not represented. The large majority (87%) had between one and four shareholders and were wholly family-owned (55%) or partly family owned (22%). Many were owner-managed (65%), since all their shareholders had access to day-to-day internal financial information.

A comparison of the size of the companies in 2002 with their 2006 accounts suggests little change. The annual turnover of 7% had grown beyond £5 million, and 1% had increased the value of their net assets beyond £2.8 million, but it should be

noted that these figures do not take account of inflation. Changes in number of employees are difficult to ascertain, since many of the companies no longer disclose figures. Not surprisingly, the majority were over 5 years old, since they had been in existence long enough to have filed accounts in 2002 and nearly half (48%) were up to 15 years old.

The main sources of external finance used in 2006 were directors' loans (34%) and borrowings from financial institutions (33%). Hire purchase or leasing was used by 23%.

The majority of companies (77%) employed an external accountant to prepare the statutory accounts in 2006 for shareholders and filing at Companies House and 48% received advice on the relevant financial reporting regulations. However, only 53% used external accountants for their tax accounts.

The increase in the turnover threshold for audit exemption from 2004 (raised from £1 million to £5.6 million), seems to have made little difference to the audit decisions made by these 94 companies and the proportion filing non-audited accounts was almost unchanged (48% in 2006 and 46% in 2002). More than half (53%) knew whether the company had a choice and the main influence on the audit decision for the 2006 accounts was the desire for consistency with previous year (50% agreed). Just over a quarter (28%) had reviewed the costs and benefits since 2003, with a similar proportion considering the cost of audit was a major burden.

In the previous survey (Collis, 2003), 54% of these companies predicted that they would continue to have the accounts audited if the thresholds were raised. The reliability of this prediction is confirmed by their decision in 2006, where 52% had been audited. The present survey found that 48% would have a voluntary audit in future if they were exempt, which supports the finding that consistency with previous years is a major factor for many companies.

In 2002, all 94 companies had filed full accounts. Based on their audit decision that year, it can be deduced that 73% were small companies, which had filed full accounts on a voluntary basis in 2002. However, by 2006, 50% had filed abbreviated accounts. The majority of directors (61%) knew whether the company had a choice and 36% had reviewed the costs and benefits since 2003. Consistency with previous years was a factor for the majority (68%), but the switching behaviour noted above suggests that it is not necessarily an overriding factor.

Nearly half the directors (47%) were of the opinion that their published accounts are useful to users and the main non-statutory recipients of the 2006 accounts were the bank and other lenders (45%) and the tax authorities (45%).

The majority of small companies (73%) had prepared their 2002 accounts using the Financial Reporting Standard for Smaller Entities (FRSSE), compared to 81% in 2006. However, care must be taken when drawing conclusions from this data, as respondents who are not familiar with accounting standards may not have verified the information they gave.

Conclusions

By focusing on a wide range of accounting and auditing issues, the results of this study contribute to the knowledge base by updating and extending previous policy-based research in the UK (in particular, Collis and Jarvis, 2000; Collis, 2003; Collis, Jarvis and Skerratt, 2004; Marriott, Collis and Marriott, 2006, POB, 2006). It reports the views of the directors on the present financial reporting options and provides an exploratory analysis of options that may become available in the near future. The views of the directors are important, because they bear the administrative and cost burdens of compliance, which the European Commission and the UK government would like to reduce. However, the research has some limitations and consultation is needed with other stakeholders, such as small accountancy practices providing services to SMEs, lenders, creditors and users of the published financial statements.

Companies House statistics show that the majority of SMEs take up the financial reporting concessions available to them, but this survey suggests a significant proportion of directors believe there are benefits in following the rules for larger entities. Therefore, further simplification of accounting and auditing rules is unlikely to assist them unless their circumstances change. The study demonstrates that consistency with previous years is one of the driving forces behind the directors' financial reporting decisions and that cost is a major factor in only a minority of companies. These results suggest that most companies are likely to maintain their current pattern of financial reporting behaviour in the short term, whilst a small proportion may benefit from reduced cost burdens as thresholds rise.

The directors' views on the European Commission's draft simplification proposals for SMEs can be summarised and compared with the views expressed in comment letters to the Commission from 23 countries (including 22 member states) as follows:

- 33% of directors supported the notion of exempting micro entities (0–9 employees) from the requirement to register accounts (compared to 80% of commentators).
- 35% of directors disagreed with the notion of exempting any SME from the requirement to register accounts (compared to a small majority of commentators).
- 42% of directors were in favour of extending audit exemption to medium-sized entities in general, but the directors of 73% of owner-managed medium companies predicted they would continue to have the accounts audited (commentators' views were divided on this subject).
- 63% of directors were against increasing the transition period for crossing the size thresholds from two to five years (compared to a small majority of commentators).

In conclusion, this study contributes to BERR's strategic priorities in connection with better regulation and reducing administrative burdens within the Corporate and Insolvency Activity Framework. The results should also be of interest to the Financial Reporting Council, the European Commission and the IASB.

1 Background to the study

Introduction

- 1.1 This report presents the results of a study that examines the views of the directors of private limited companies on the accounting and auditing requirements and options for small and medium-sized entities (SMEs). Commissioned in August 2007 by the former Department of Trade and Industry (DTI), now the Department of Business, Enterprise and Regulatory Reform (BERR), it demonstrates the government's evidence-based approach to policymaking (Cabinet Office, 1999).
- 1.2 The study took the form of a postal questionnaire survey of non-publicly accountable SMEs (see Appendix), which are the intended beneficiaries of the regulatory reforms made in the Companies Act 2006. They are also intended to benefit from draft proposals made by the European Commission to simplify the rules for SMEs in EU company law, accounting and auditing directives (EC, 2007a).
- 1.3 The views of the directors are vital because they are the main users of the statutory accounts (Page, 1984; Carsberg, Page, Sindall and Waring, 1985; Barker and Noonan, 1996), which they use for a range of internal and external purposes (Collis and Jarvis, 2000). Furthermore, the directors are responsible for evaluating the costs and benefits of the financial reporting options available and choosing the strategy that best meets the company's needs.

Purpose

- 1.4 The purpose of the study is to provide empirical evidence that will contribute to BERR's strategic priorities in connection with better regulation and reducing administrative burdens within the Corporate and Insolvency Activity Framework. The research has three objectives:
 - to investigate the views of the directors of SMEs on the accounting and auditing options in company law and to update and extend the previous research, which contributed to the 'think small first' approach in the Companies Act 2006;
 - to seek their views on the simplification draft proposals made by the European Commission (EC, 2007a);
 - to identify changes in financial reporting practices of companies that had also participated in the previous study (Collis, 2003).

Structure of the report

1.5 The remainder of the report is structured as follows:

- Chapter 2 provides an overview of developments in the regulation of financial reporting by SMEs in the UK since the 1980s.
- Chapter 3 explains the research design and the methods used.
- Chapter 4 describes the characteristics of the sample companies, using data from the survey and the statutory annual report and accounts.
- The survey results relating to accounting are presented in Chapter 5 and those relating to auditing are contained in Chapter 6.
- Chapter 7 contains a longitudinal analysis of the subset of companies that had participated in the previous study (Collis, 2003) as well as the present survey.
- The final chapter discusses the main findings and the study's contribution to the evidence base.

2 Accounting and auditing requirements for SMEs

Introduction

- 2.1 The rationale for simplifying the financial reporting requirements for SMEs is the need to reduce regulatory burdens that fall disproportionately on smaller entities. SMEs are considered to be 'the backbone of the European economy, acknowledged as a constant source of ideas, innovation and entrepreneurial skills, the principal providers of existing jobs and the main source of new employment' (EC, 2006, p. 1). This chapter provides an overview of how the regulation of financial reporting by SMEs has developed in the UK to date and outlines the European Commission's draft proposals for further simplification.
- 2.2 The move towards a less onerous regime for SMEs in Europe is related to the increased importance of smaller entities since the 1980s. For example, between 1980 and 2005 in the UK, the total number of business enterprises grew by nearly 80% to 4.3 million. This was mainly due to more micro-businesses (1 to 9 employees) and one-person companies (SBS, 2002). By the start of 2006, there were an estimated 4.5 million businesses, of which 1.1 million (26%) were companies³ (BERR, 2007, Table 2). The vast majority of companies (97%) were small (0 – 49 employees) and 2% were medium (50 – 249 employees); together these SMEs accounted for 46% of turnover and 44% of jobs in the UK.
- 2.3 The above classification of size by employees is the one used by the Office for National Statistics, but size is a more complex and dynamic concept in company law. The Fourth Company Law Directive (78/660/EEC) provides qualitative and quantitative tests for defining a small or medium-sized company and the maxima in the size tests are subject to revision approximately every five years to take account of monetary and economic trends. However, national governments can set lower thresholds if they wish.
- 2.4 When the financial reporting options for SMEs were first introduced in the UK, the thresholds were set at a lower level than the EU maxima, and the turnover threshold for audit exemption was lower than for the accounting options. Subsequently, the UK raised the thresholds in a series of steps, until in 2004 they were standardised for all financial reporting options and harmonised with the EU maxima. In April 2008, the UK thresholds were raised again to align them with the revised EU maxima.
- 2.5 In general, unless excluded for reasons of public interest, an entity qualifies as small or medium in relation to a financial year if it meets two or more of three size criteria relating to turnover, balance sheet total and average number of employees in its first year. In a subsequent financial year, it must qualify or satisfy the size tests in that year and the preceding year. The

³ This category includes public corporations and nationalised bodies.

conditions for exemption from audit are that the entity qualifies as small in relation to that year and meets both the turnover and balance sheet criteria for that year.⁴ Table 2.1 summarises the thresholds for entities with accounting periods starting on or after 6 April 2008.

Table 2.1 UK thresholds for small and medium entities from April 2008

Criteria	Small company	Medium company
Turnover	£6.5m (€8.8m)	£25.9m (€35.0m)
Balance sheet total	£3.26m (€4.4m)	£12.9m (€17.5m)
Average employees	50	250
	Small group	Medium group
Aggregate turnover	£6.5m net or £7.8m gross	£25.9m net or £31.1m gross
Aggregate balance sheet total	£3.26m net or £3.9m gross	£12.9m or £15.5m gross
Aggregate average employees	50	250

Statutory accounts

- 2.6 The Fourth Directive (78/660/EEC) requires all EU companies to make their accounts available at a registry on the basis that anyone dealing with a limited liability entity should be able to see the accounts. However, the Directive recognises that it could disadvantage smaller entities if too much detail were published. Therefore, national governments can provide an option allowing non-publicly accountable SMEs to register abridged accounts.
- 2.7 In the UK, the option for qualifying small and medium-sized entities to file abridged accounts was introduced in 1981 and the financial thresholds were raised by approximately 40% in 1992.⁵ This option gives exemption from the requirement to file a profit and loss account or directors' report, and requires the company to publish an abbreviated balance sheet only. Abbreviated accounts are drawn from the full accounts that all companies are required to prepare for shareholders, but because they exclude information on financial performance, they are not capable of giving a true and fair view (PricewaterhouseCoopers, 1999).
- 2.8 Table 2.2 summarise the changes in the UK size thresholds for small and medium-sized entities filing abbreviated accounts since 1981.

⁴ The detailed rules can be found in the Companies Act 2006, c. 45, Parts 15 and 16. See Appendix 1 for a summary of the thresholds for companies with accounting periods starting on or after 6 April 2008.

⁵ The Companies Act 1981 referred to 'modified' accounts. Since the Companies Act 1989, the term 'abbreviated' accounts has been used in UK company law.

Table 2.2 UK thresholds for abbreviated accounts 1981 - 2008

	1981	1992	2004	2008
Small				
Turnover	£1.4m	£2.8m	£5.6m	£6.5m
Balance sheet total	£0.7m	£1.4m	£2.8m	£3.26m
Average employees	50	50	50	50
Medium				
Turnover	£5.75m	£11.2m	£22.8m	£25.9m
Balance sheet total	£2.8m	£5.6m	£11.4m	£12.9m
Average employees	250	250	250	250

Financial Reporting Standard for Smaller Entities

- 2.9 In the UK, the Accounting Standards Board (ASB) is responsible for setting Financial Reporting Standards (FRS). These are authoritative statements of 'how particular types of transaction and other events should be reflected in financial statements. Compliance with accounting standards will normally be necessary for financial statements to give a true and fair view' (CIMA, 1996, p. 6), which is a requirement of UK company law.
- 2.10 In 1997, the ASB issued the *Financial Reporting Standard for Smaller Entities* (FRSSE). Their aim was to reduce burdens on small companies, whilst ensuring that financial statements intended to give a true and fair view provide information that is useful to users. 'The FRSSE is designed to provide smaller entities with a single accounting standard that is focused on their particular circumstances' (ASB, 2005, p. 169). Qualifying small companies or groups can adopt the FRSSE in place of the full range of accounting standards⁶ and fallback to full standards is permitted if a particular transaction or event is not covered in the FRSSE.
- 2.11 If the FRSSE is adopted, the financial statements must state that they have been prepared 'in accordance with the Financial Reporting Standard for Smaller Entities (effective January 2005)' (ASB, 2005, p. 16). This can be included in the note on accounting policies or, if abbreviated accounts are also prepared, in the statement required by company law to be given on the balance sheet.
- 2.12 The FRSSE is subject to periodic revision to reflect developments in the full range of accounting standards and revised versions came into effect in 1998, 2000 and 2005. The 2005 version turned the FRSSE into a 'one-stop shop' by incorporating the relevant requirements from company law.

⁶ A small group adopting the FRSSE also needs to apply certain other standards.

International Financial Reporting Standard for SMEs

- 2.13 The International Accounting Standards Board (IASB) sets accounting standards known as International Financial Reporting Standards (IFRS), which can be adopted by any country. Since 2005, group companies with a listing on an EU stock exchange have been required to follow IFRS in their consolidated financial statements, and national governments may extend the requirement to single entities and unlisted companies. In the UK, the use of IFRS is a requirement for all listed groups and a choice for single companies and unlisted entities.
- 2.14 In 2007, the IASB issued an exposure draft of the IFRS for SMEs, with the following objectives:
- to provide high quality, understandable and enforceable accounting standards suitable for SMEs globally
 - to reduce the financial reporting burden on SMEs that want to use global standards
 - to meet the needs of the users of SMEs' financial statements.
- 2.15 The IFRS for SMEs is a simplified, self-contained set of accounting principles that are appropriate for smaller, unlisted companies and is based on the full range of IFRSs. In due course, national governments will be able to decide whether to adopt it and which companies will be permitted to use it. The exposure draft defines an SME as an entity that does not have public accountability and publishes general-purpose financial statements for external users. A non-publicly accountable entity is defined as an entity:
- whose shares are not publicly traded
 - that is not a financial institution or an essential public service
 - that is not economically significant in its own country.

Statutory audit

- 2.16 The Fourth Directive (78/660/EEC) requires the accounts of all non-dormant limited liability entities to be audited, but allows national governments to provide an option giving exemption to non-publicly accountable small entities within their jurisdictions. The statutory audit is an external audit that involves 'an independent examination of, and the subsequent expression of opinion on, the financial statements of an organization' (Oxford Dictionary of Accounting, 2005, p. 34).
- 2.17 In the UK, audit exemption was introduced in 1994 (SI 1994/1935). The option applies to a company that qualifies as small for filing abbreviated accounts, but not if audit is required by shareholders holding at least 10% of issued share capital. Initially the turnover threshold set at £90,000, which was lower than the level for filing abbreviated accounts (which itself was lower than the

EU maximum). A company with a turnover between £90,000 and £350,000 was given the option of filing an accountant's compilation report, but this was dropped in 1997 when the threshold was raised to £350,000 (SI 1997/936). In 2000, the threshold was increased to £1 million (SI 2000/1430) and raised to the EU maximum of £5.6 million (SI 2004/16) in 2004. The changes to date are summarised in Table 2.3.

Table 2.3 UK thresholds for total audit exemption 1981 - 2008

Criteria	1994	1997	2000	2004	2008
Turnover	£0.09m	£0.35m	£1.0m	£5.6m	£6.5m
Balance sheet total	£1.4m	£1.4m	£1.4m	£2.8m	£3.26m
Average employees	50	50	50	50	50

- 2.18 A further change in 2004 was the requirement that an exempt company with a turnover between £1 million and £5.6 million must file an audit exemption report (AER) stating that, in the opinion of the accountant, the accounts are in agreement with the company's accounting records and have been drawn up in a manner consistent with the Companies Act. The AER must also state that based on the information contained in the accounting records, the company is entitled to audit exemption on the basis of size.
- 2.19 Revised guidelines from the UK's Auditing Practices Board (APB, 2006) require auditors of entities submitting abbreviated accounts to make a special report that the entity is entitled to deliver abbreviated accounts and that they have been prepared properly. If the auditor's report on the full accounts is qualified, company law requires the special report on the abbreviated accounts to set this out. If the auditor's report on the full accounts is unqualified but contains an emphasis of matter paragraph, this and any further materials needed to understand it must be included in the special report.

Proposed EU simplifications

- 2.20 In July 2007, the European Commission invited comment on draft proposals for a simplified business environment in the areas of company law, accounting and auditing (EC, 2007a). The main suggestions relating to SMEs were:
- to introduce a new category of micro entities using size tests based on turnover below €1 million (£0.74 million), balance sheet total below €0.5 million (£0.37 million) and fewer than 10 employees⁷
 - to exempt micro entities from the scope of the Fourth Directive (the accounting directive)
 - to extend the transition period for SMEs crossing the size thresholds from two year to five years

⁷ Sterling equivalents based on conversion rates used for EU 2008 size thresholds.

- to exempt small entities from the requirement to publish their accounts
- to permit owner-managed medium-sized entities and unlimited companies to use rules currently available to small entities only.

2.21 By mid October 2007, the Commission had received responses from 23 countries, including 22 member states and published an analysis in December 2007 (EC, 2007b). The responses relating to the suggestions for SMEs can be summarised as follows:

- Approximately 80% supported the notion of exempting micro entities from the scope of the accounting directive.
- A small majority disagreed with the notion of exempting small entities from the requirement to publish their accounts.
- Respondents were divided over the draft proposal to allow owner-managed medium-sized entities to use rules for small companies, but there was support for relaxation in the case of unlimited companies.
- A small majority was against increasing the transition period for SMEs crossing the size thresholds from two to five years, but some respondents were agreeable to increasing the period to three years.

3 Methodology

Introduction

- 3.1 The research was designed as a large-scale postal questionnaire survey of the directors of small and medium-sized private companies with the following aims:
- to investigate the views of the directors of SMEs on the accounting and auditing options in company law;
 - to seek their views on the European Commission's draft proposals for further simplifications;
 - to identify changes in financial reporting practices of companies that had also participated in the previous study (Collis, 2003).

Sample selection

- 3.2 One of the main challenges in financial studies of SMEs is the absence of a comprehensive database from which to draw a sample. Previous research (for example, Collis and Jarvis, 2000; Collis, 2003) used the FAME database and this strategy was adopted as the sampling frame in the present study to provide continuity. Over the years, the FAME database has been extended. It now contains up-to-date information based on the annual returns made by 2.8 million companies in the UK and Northern Ireland. However, one limitation remains: it is not fully representative of the very smallest companies (those with a turnover under £0.5 million).
- 3.3 The qualitative selection criteria for the study were that the entity had a registered office in England or Northern Ireland and a director's name was provided; in addition, that it was active, private and independent,⁸ and had filed the 2006 accounts by the end of August 2007. Companies with activities in code J Financial Intermediation were deselected, as they are excluded from the small companies' regime on grounds of public interest.
- 3.4 Table 3.1 shows the sample was spread across all the remaining industries and is broadly representative of the population from which it was drawn. This table analyses the companies according to their National Office of Statistics Standard Industrial Classification (2003) code and confirms that the majority have activities in the service sector.

⁸ Subsidiaries were excluded.

Table 3.1 Distribution by industry

Standard Industrial Classification		% of sample	% of population
A, B	Agriculture, Hunting and Forestry; Fishing	1.8	1.3
C, E	Mining and Quarrying; Electricity, Gas and Water Supply	0.3	0.4
D	Manufacturing	16.4	13.6
F	Construction	12.0	12.2
G	Wholesale and Retail Trade; Repairs	20.9	19.4
H	Hotels and Restaurants	1.9	2.3
I	Transport, Storage and Communication	4.5	4.8
K	Real Estate, Renting and Business Activities	34.7	36.7
M	Education	0.9	1.0
N	Health and Social Work	1.2	1.3
O	Other Community, Social and Personal Service Activities	5.4	7.0
Total		100.0	100.0

N = 1,294 (sample); 9,458 (population)
Source: 2006 accounts

3.5 The selection criteria relating to size were based on balance sheet total and number of employees. The maxima were based on the April 2008 thresholds for a medium-sized entity, so that companies likely to be reclassified as medium were included in the sample. Turnover was not used this time, to ensure that companies registering abbreviated accounts, where turnover is not disclosed, were included. The maxima were as follows:

- balance sheet total £12.9 million
- employees 250.

Data collection

3.6 The research data was collected via a postal questionnaire (see appendix). The questions were guided by recent case study research of SMEs and their external accountants (Marriott, Collis and Marriott, 2006) and recent draft proposals for regulatory reform. The questionnaire was developed jointly with BERR and draft questions were discussed with experts in the accountancy profession and piloted with the directors of SMEs through face-to-face interviews.

3.7 The application of the selection criteria generated an initial list of 9,681 companies. The questionnaire and freepost return envelope were sent with a letter explaining the purpose of the survey to the company secretary or principal director by name in September 2007. Despite the fact that the names and addresses were those registered at Companies House, some envelopes were returned 'gone away'. In other cases, the questionnaire was returned

blank or the director got in touch to say he or she was unable to participate; the company had become dormant; it had closed or it was in the process of liquidation. This reduced the list to 9,458 companies, which included 463 of the original 790 companies from the 2003 survey. By 31 October 2007 (the cut off date), 1,294 useable questionnaires had been received, including 94 from companies whose directors had participated in the 2003 survey.

Data analysis

- 3.8 The data was entered into SPSS and verified. As this is a descriptive study, the analysis is mainly univariate, but key results are supported by measures of central tendency and tests of association based on a significance level of 5%.
- 3.9 Unless stated otherwise, the classification of the sample companies into 'small' and 'medium' is based on the respondent's answer to question 7 regarding the audit decision in 2006 (see Appendix).

Generalisability

- 3.10 The response rate of 14% is considerably lower than the 30% achieved by the previous study (Collis, 2003). There are several possible reasons for this, such as the unforeseen postal strikes and the necessity of conducting the survey during the holiday season to provide timely interim results by the end of September. In addition, there was the fact that the stationery used for the previous study carried the well-known DTI logo, but the present survey went out under the logo of the new Department for Business, Enterprise and Regulatory Reform, which was barely a month old at the time.
- 3.11 The size of the sample (1,294 companies) is sufficient to represent the population from which it was drawn, as it exceeds the minimum acceptable size of 384 for a population of 1 million or more (Krejcie and Morgan, 1970, p. 608). The response rate of 14%, although lower than the 2003 study, was satisfactory when compared to other postal questionnaire surveys of SMEs. For example, 12% achieved by Poutziouris, Chittenden and Michaelas (1998); 11% by the ICAEW (1996); and 13% in the seminal study by Bolton (1971) in his accounting survey.
- 3.12 However, some bias was present. Table 3.2 compares the size characteristics of the 9,458 companies that met the selection criteria (the population) with the 1,294 companies in the sample. Since size is positively skewed in the population (considerably more companies at the smaller end of the scale), the median gives a more appropriate measure of central tendency than the mean. A cursory glance shows that the median balance sheet total and average number of employees is slightly larger for the sample than for the population. This means that non-respondents were likely to have been smaller in terms of these two size measures.

3.13 Two reasons for this emerge from the messages received from those unable to participate: first, the directors of very small companies are too busy running the business to answer surveys; and second, they feel the issues are of little relevance to them due to their small size. These sorts of problems and the lack of availability of up-to-date lists of small businesses are cited as the main reasons for poor response rates in small business research (Curran and Blackburn, 2001). The sampling frame for this study was based on the returns made to Companies House. At the time of the study, private companies could file their accounts up to 10 months after the end of their accounting reference period. Some start-up companies may not last long enough to file their first set of accounts, whilst in other cases the company may have changed its legal form or been acquired or otherwise sold. This explains why it is difficult to obtain a sample that is fully representative of the very smallest companies.

Table 3.2 Descriptive statistics for size variables

Criteria	N	Min	Max	Median	Mean	SD
Balance sheet total						
Population	9,458	−£2.91m	£12.89m	£0.35m	£1.24m	1.975
Sample	1,294	−£0.02m	£12.71m	£0.75m	£1.54m	2.125
Employees						
Population	9,232	1	250	9.00	38.63	52.840
Sample	1,246	1	248	25.00	47.57	54.991

Source: 2006 accounts

3.14 The results of this survey cannot be generalised to the smallest companies, as the sampling frame was not representative of those with a turnover under £0.5 million and there was a poor response from those with few or no employees. However, since Companies House statistics already provide information on the take-up rates of the options offered, this study endeavours to contribute to our understanding of the reasons for the financial reporting choices made and the likely behaviour of companies of a similar size to those studied.

Comparison with the 2003 study

3.15 Since the present research was designed to extend the previous study (Collis, 2003), there were many similarities in terms of research design:

- Both studies were postal questionnaire surveys of active, independent private limited companies in the UK and Northern Ireland.
- In both cases, the FAME database provided the sampling frame and the companies were selected from all industrial sectors, apart from financial intermediation.

- In both cases, information relating to the latest accounts filed at Companies House was analysed (the 2002 accounts in the previous study and the 2006 accounts in the present study).

3.16 However, the size of the companies studied differed and by the time of the present study, the size definitions in company law had changed. The 2003 study focused solely on small companies, as defined by the EU maxima for a small company at that time, since the study was part of the consultation on raising the audit exemption thresholds. On the other hand, the size criteria for the present study are based on the April 2008 EU maxima for a medium company, because the study focuses on a wide range of issues that are relevant to both small and medium-sized companies. The size selection criteria for the two studies are contrasted in Table 3.3.

Table 3.3 Comparison of the size selection criteria for the two studies

Criteria	2003 survey (Collis, 2003)	2007 survey (Collis, 2008)
Turnover	£4.8m	Not used
Balance sheet total	£2.4m	£12.9m
Average number of employees	50	250

3.17 The analysis of the subset of the 94 companies that had also participated in the previous survey (Collis, 2003) permits a longitudinal study of these firms (see Chapter 7). However, the results may not be generalisable to the 463 companies remaining in scope from the 2003 survey, since a sample of 94 is too small to be representative. For the same reason, care should be taken to avoid comparing the results for this subset of 94 companies with the findings for the whole sample of 1,294 companies reported in Chapters 4 – 6. Despite these limitations, the longitudinal analysis in Chapter 7 provides a number of useful insights into the responses of this subset of small companies to recent developments in the regulation of financial reporting.

4 The sample companies

Introduction

4.1 This chapter describes the characteristics of the sample companies. The analysis commences with key demographics and then examines agency relationships and the services received from external accountant(s). Since 89% of the questionnaires were completed by a director or company secretary and a further 11% by a manager or accountant, it is reasonable to conclude that the respondents were in a position to provide valid information.

Ownership, size and age

4.2 The large majority of companies (77%) had between one and four shareholders. In 49%, the company was wholly family-owned (only one shareholder or all are related) and a further 23% were partly family-owned. More than half (55%) can be described as owner-managed, since all their shareholders had access to day-to-day internal financial information.

4.3 Reflecting the wider population, the majority of companies were at the smaller end of the scale in terms of turnover, balance sheet total and average number of employees. These criteria are of interest because of their role in the size tests in company law.⁹ The mean is not a valid measure for measuring company size, as there are many more entities at the smaller end of the scale. Therefore, the mode (the most frequently occurring value) and/or the median (the mid point) are provided as measures of central tendency.

4.4 As qualifying small and medium-sized entities can file abbreviated accounts, which do not disclose their turnover, it was anticipated that some directors would be reticent about giving a precise figure in the survey. Therefore, they were merely invited to indicate their turnover category for the year ending 2006. The results in Table 4.1 reflect the distribution of size in the sample companies rather than its distribution in the population and indicate that at least 50% were small by this measure (a turnover of £5.6 million being the threshold in 2006).

⁹ See Table 2.1.

Table 4.1 Turnover in 2006

Turnover category	% of companies
Up to £1m	34
£1.1m – £5m	16
£5.1m – £10m	22
£10.1m – £15m	11
£15.1m – £20m	6
More than £20m	10
No response	1
Total	100

N = 1,294

Source: Survey question 17

- 4.5 Table 4.2 analyses the size of the companies according to their balance sheet total and shows the vast majority (83%) were small in 2006 (up to £2.8 million). This is reflected in a mode of less than £1,000 and a median of £0.75 million (see Table 3.2). These results contrast sharply with Table 4.1, where the split between small and medium based on turnover was almost equal. This is likely to be due to the preponderance of small companies in service sectors and the difficulty of measuring the intangible assets of knowledge-based enterprises for inclusion in the balance sheet.

Table 4.2 Balance sheet total in 2006

Balance sheet total	% of companies
Up to £2.8m	83
£2.801m – £11.4m	16
£11.401m – £12.9m	1
Total	100

N = 1,294

Source: 2006 accounts

- 4.6 Table 4.3 considers the size of the companies in terms of the average number of persons employed in 2006, where this is available (companies subject to the small companies regime are not obliged to disclose this figure). The results show that once again the majority (59%) were small entities (up to 50 employees). Further analysis found that 39% could be classed as micro entities (1 – 9 employees) and the median was a workforce of 25 (see Table 3.2) with a mode of two employees.

Table 4.3 Average employees in 2006

Number of employees	% of companies
1 – 50	59
51 – 250	37
None/Not available	4
Total	100

N = 1,294

Source: 2006 accounts

- 4.7 One respondent took the trouble to point out that ‘the average number of employees in the year may be a poor proxy for size, given the increased use of outsourcing to other firms and self-employed contractors’. Thus, a company in the service sector with few assets and a large but fluctuating population of self-employed staff (eg market research consultancies) may qualify as small, regardless of its turnover being above the threshold each year.
- 4.8 The age of the company in 2006 was calculated from the year of incorporation. Table 4.4 shows that 75% had survived the first 5 years, when small firms are most vulnerable to failure (Milne and Thomson, 1986; Storey, 1994); indeed, 25% had been contributing to the economy for more than 25 years. The average age was 19 years and the mode 3 years, but this analysis can only provide a guide to the maturity of the business, as some may have existed previously as unincorporated entities.

Table 4.4 Age in 2006

Number of years	% of companies
Up to 5	25
6 – 10	19
11 – 15	13
16 – 20	10
21 – 25	8
More than 25	25
Total	100

N = 1,294

Source: 2006 accounts

- 4.9 Table 4.5 shows the results of tests for association between the ownership size, age and gearing variables. Not surprisingly, there is strong positive correlation between the three size variables: turnover, balance sheet total and number of employees. The relevant correlation coefficients are highlighted in

blue in the table. The table shows medium correlation between balance sheet total and age. This seems rational, as older companies will have had longer to accumulate business assets. The weak negative correlation between family ownership and size (as measured by turnover and employees), suggests that family-owned businesses are likely to have lower revenue and employ fewer staff. Family owned businesses are also weakly but positively correlated with age, suggesting that family-owned companies tend to be older than those whose shareholders are unrelated. However, care must be taken when interpreting these results, because companies with only one shareholder were included in the family-owned category.

Table 4.5 Spearman's correlation matrix for ownership, size and age

Variable	Family ownership	Turnover category	Balance sheet total	Employees	Age
Family ownership	1.000				
Turnover category	-.134**	1.000			
Balance sheet total	-.013	.703**	1.000		
Employees	-.112**	.728**	.684**	1.000	
Age	.170**	.235**	.413**	.294**	1.000

N = 1,294 (cases excluded pairwise)

** Correlation is significant at the 0.01 level (2-tailed).

Key financial indicators

- 4.10 Descriptive statistics for key financial indicators taken from the 2006 accounts are presented in Table 4.6. The ratios were provided by FAME using standard formulae. Nevertheless, care should be taken when interpreting these measures of dispersion and central tendency, as ratios are industry sensitive. The first two key indicators are profitability ratios and the third is an investor ratio. As its name suggests, the fourth ratio measures the liquidity of the business, which is an important indicator of the business's ability to cover its short-term liabilities. Related to this is the gearing ratio, which reflects the relationship between long-term borrowings and the equity invested in the business. The QuiScore measures the likelihood of company failure in the following year and is based on a scale of 0 to 100 (where 1–20 = high risk; 21–40 = caution; 41–60 = normal; 61– 80 = stable; and 81–100 = secure).

Table 4.6 Key financial indicators in 2006

Indicator	N	Min	Max	Mean	SD
Profit margin (%)	844	-98	399	14.44	26.089
Return on capital employed (ROCE) (%)	1,192	-569	969	38.34	94.010
Return on shareholders' funds (%)	1,179	-569	976	47.21	111.540
Liquidity (x:1)	1,265	0	55	2.08	4.339
Gearing (%)	1,075	0	964	238.48	758.903
QuiScore	1,287	13	95	73.90	22.455

Source: FAME

- 4.11 Table 4.7 shows the results of tests for association between selected financial indicators and the age of the company. There is evidence of medium positive association between age, size and QuiScore, suggesting that older and larger companies have higher (better) credit rating scores than their smaller counterparts. The relevant correlation coefficients for the strong relationships are highlighted in blue.

Table 4.7 Spearman's correlation matrix for age, size and financial indicators

Variable	Age	Small size	Profit margin	ROCE	Liquidity	Gearing	Qui-Score
Age	1.000						
Size	-.266**	1.000					
Profit margin	-.320**	.309**	1.000				
ROCE	-.350**	.181**	.721**	1.000			
Liquidity	.056*	.194**	.234**	.097**	1.000		
Gearing	-.283**	.029	-.115**	-.077*	-.538**	1.000	
QuiScore	.557**	-.595**	-.317**	-.164**	-.094**	-.141**	1.000

N = 1,294 (cases excluded pairwise)

** Correlation is significant at the 0.01 level (2-tailed).

* Correlation is significant at the 0.05 level (2-tailed).

External sources of finance

- 4.12 Overall, 83% of SMEs indicated that they were funded by debt finance in 2006. Table 4.8 analyses the range of external sources of finance used in 2006 (respondents could tick as many sources as applied). The three main sources were similar for both small and medium-sized companies. However, whilst directors' loans and/or bank finance were used by at least a third of small companies, more than half the medium-sized companies used bank finance and/or asset-based finance (hire purchase or leasing).

Table 4.8 External sources of finance in 2006¹⁰

Source	% of small companies	% of medium companies
Directors' loans	37	29
Loans/mortgages from banks/financial institutions	33	59
Hire purchase or leasing	22	52
Debt factoring or invoice discounting	6	17
Forward payments from customers	6	7
Loans from family and friends	5	4
Loans from company pension funds	2	6
Venture capital/business angel finance	2	4
Debentures	0	3

N = 1,294 (592 small and 702 medium)

Source: Survey question 3 (more than one response was possible)

Services from external accountant(s)

4.13 Overall, 83% of SMEs used an external accountant to prepare their 2006 accounts for shareholders, filing and the tax authorities. Table 4.9 shows the full range of services received from external accountants (respondents could tick as many as applied). As can be seen, a larger proportion of medium companies than small companies received advice on financial reporting regulations whilst the reverse was true in connection with advice on bookkeeping and periodic management accounts. These, and some of the other differences between companies of different sizes, may be due to contingency factors at different stages in a company's development.

¹⁰ The classification of companies into 'small' and 'medium' is based on the respondent's answer to question 7 regarding the audit decision in 2006 (see Appendix).

Table 4.9 Services from external accountant(s) in 2006¹¹

Service	% of small companies	% of medium companies
Preparing statutory accounts for shareholders and Companies House	77	88
Preparing accounts for the tax authorities	56	66
Advice on accounting/auditing regulations	49	71
General advice on running a company	22	16
Bookkeeping or preparing periodic management accounts	17	10
Additional detailed annual accounts for management's use	16	19
Management advice in connection with the annual results	15	25
Preparing accounts for the bank/lenders	10	15
Advice on raising finance	4	7
Preparing accounts for major suppliers or customers	1	4

N = 1,294 (592 small and 702 medium)

Source: Survey question 4 (more than one response was possible)

¹¹ The classification of companies into 'small' and 'medium' is based on the respondent's answer to question 7 regarding the audit decision in 2006 (see Appendix).

5 Accounting

Introduction

5.1 This chapter describes the survey results relating to the filing requirements for SMEs. All companies must register their accounts at Companies House and qualifying small and medium-sized entities in the UK are given the option of filing abbreviated accounts.¹² For a qualifying small company, this provides exemption from the requirement to file a profit and loss account or directors' report, and requires the entity to publish an abbreviated balance sheet only. A qualifying medium-sized company may file an abbreviated profit and loss account, abbreviated balance sheet and related directors' report. The chapter also examines the results relating to the choice of accounting standards for SMEs. Accounting standards have a major influence on financial reporting, since compliance with them is normally necessary for financial statements to give a true and fair view, as prescribed by company law.

Filing decision

5.2 In total, 68% of the respondents stated that the company had registered full accounts in 2006, including 25% who had done so on a voluntary basis. Table 5.1 shows that only 32% had filed abbreviated accounts, but it must be remembered that the sample, which was not representative of the smallest companies, which were likely to have chosen this option.

Table 5.1 Filing decision in 2006

Decision	% of companies
Statutory full accounts (above the size thresholds)	43
Voluntary full accounts (small or medium company)	
Because there are benefits in doing so	21
Because the company was close to the threshold	4
Abbreviated accounts (small or medium company)	32
Total	100

N = 1,294

Source: Survey question 20

5.3 Table 5.2 shows that 60% of the directors knew whether the company had a choice in the type of accounts they filed at Companies House. However, the main factor influencing the filing decision in 2006 was the desire for consistency with previous year (65% agreed), which may account for the relatively small proportion (27%) acknowledging that they had reviewed the

¹² The entity is still required to prepare full accounts for shareholders.

costs and benefits since 2003. Cost was a major factor for only 21% of companies. Although abbreviated accounts avoid disclosing turnover, this was not a factor in the filing decision for 66% of companies.

Table 5.2 Factors affecting the filing decision in 2006 (% of companies)

Factor	Agree	Disagree	N/R	Total
Consistency with previous years was a major factor	65	27	8	100
We knew whether the company had a choice	60	27	13	100
Disclosing annual accounts is the 'price' paid for limited liability	58	34	8	100
Our accounts at Companies House are useful to users	56	33	11	100
We had reviewed the costs and benefits since 2003	27	60	13	100
Disclosing turnover is/would be a major disadvantage	22	66	12	100
The cheapest option was a major factor	21	67	12	100
Our accounts are also on our website	3	84	13	100
We only file full accounts when the results are good	1	86	13	100

N = 1,294

Source: Survey question 21

Users of the published accounts

- 5.4 Table 5.3 identifies who normally receives a copy of the company's accounts (apart from shareholders and Companies House), and shows that lenders and the tax authorities are the main non-statutory recipients.

Table 5.3 Recipients of the 2006 accounts

Recipient	% of companies
The bank and other lenders	67
Tax authorities	50
Directors or other employees who are <u>not</u> shareholders	31
Major suppliers and trade creditors	12
Major customers	10
Credit rating agencies	9
Industry regulators (eg FSA, CAA, ABTA)	5

N = 1,294

Source: Survey question 5 (more than one response was possible)

5.5 Table 5.2 showed that more than half the directors (56%) considered the accounts published at Companies House are useful to users. Another question asked them who they thought these users might be. Table 5.4 shows the main user groups are those who need information for assessing credit or lending risk, many of whom are also direct recipients of the accounts (see previous table). Only 57% of directors thought that competitors were using the published accounts. This relatively small proportion may be due to some SMEs having activities in niche markets or operating in locations where there is little or no competition.

Table 5.4 Users of the published accounts

User group	% of companies
Suppliers and other trade creditors	64
Credit rating agencies	62
Competitors	57
Bank and other lenders	46
Customers	41
Government departments and agencies	38
Potential investors or acquirers	35
Directors and employees who are <u>not</u> shareholders	20
Members of the public	17

N = 1,294

Source: Survey question 22 (more than one response was possible)

5.6 Under the Companies Act 2006, private companies must file their annual accounts and reports within 9 months (previously 10 months) of the year-end and there are penalties for late filing. In addition to meeting legal obligations, timeliness contributes to the usefulness of the published financial statements to users (IASB, 1989; ASB, 1999). It was noted in Table 4.9 that an external accountant prepared the 2006 accounts in 83% of companies. Table 5.5 shows the time lag between the year-end and receipt of the accounts. Although all were probably received within the prescribed period for filing, 33% received their accounts very promptly (within 10 weeks).

Table 5.5 Time lag from year-end to receipt of the 2006 accounts

Number of weeks	% of companies
0 – 10	33
11 – 20	46
21 – 30	14
31 – 40	6
More than 40	1
Total	100

N = 1,215

Source: Survey question 19

Filing exemption for micro entities

- 5.7 Although a total of 65% of companies supported the European Commission's draft proposal that smaller entities might be exempt from the statutory requirement to register accounts. Table 5.6 shows that the greatest proportion of these (33%) supported exemption for micro entities only (0–9 employees). Not surprisingly, this view was significantly associated with small companies rather than medium companies (chi-square 91.770; $p \leq 0.01$).

Table 5.6 Filing exemption for micro entities

Response	% of companies
Exemption for	
Micro entities (0 – 9 employees)	33
Both micro and small entities (0 – 50 employees)	18
All SMEs (0 – 250 employees)	14
No exemption	35
Total	100

N = 1,275

Source: Survey question 23

- 5.8 The question on filing exemption provoked several comments on disclosure requirements, including the following points:
- 'Small company accounts are already too meaningless to be of much use'.
 - 'Traders who wish to use a company format ... should be able to have an "unlimited" company if they do not wish to be audited and/or do not wish to disclose their results'.
 - 'Any business limiting its liability to creditors should be required to be audited and to report its financial status (ie balance sheet and p&L a/c).

Personally, I think companies not wishing to file their accounts are likely to be precisely the ones to benefit most from being forced to publish a cash flow statement too.'

Financial Reporting Standard for Smaller Entities

5.9 Qualifying small entities in the UK can prepare their statutory accounts using the Financial Reporting Standard for Smaller Entities (FRSSE). If the FRSSE is adopted, the entity is exempt from compliance with the full range of accounting standards that must be used by medium and large companies. Table 5.7 indicates that 69% of the small companies had used the FRSSE as the basis of the 2006 accounts, but care must be taken when drawing conclusions from this data, as respondents who were not familiar with accounting standards may not have verified the information they gave.

Table 5.7 Use of the FRSSE by small companies for the 2006 accounts¹³

Decision	% of small companies
Used the FRSSE	69
Did not use the FRSSE	31
Total	100

N = 557

Source: Survey question 24

International Financial Reporting Standard for SMEs (Private Entities)

5.10 The directors were asked whether it would be an advantage to the company to be allowed to prepare the statutory accounts using the new IFRS for SMEs (Private Entities). It was explained that this is based on the standard terms and methods of measurement used by large companies in the EU and many other countries, and that it could aid comparability for overseas users of the company's accounts. Table 5.8 shows that 25% of respondents considered it could be a benefit and further analysis found this was likely to be directors of medium companies rather than small companies (chi-square 5.916; $p \leq 0.05$).

¹³ The classification of companies into 'small' and 'medium' is based on the respondent's answer to question 7 regarding the audit decision in 2006 (see Appendix).

Table 5.8 Advantageous to use the IFRS for SMEs (Private Entities)

Response	% of companies
Yes	25
No	75
Total	100

N = 1,207

Source: Survey question 25

Transition period for SMEs

- 5.11 Under company law, if a small company exceeds the size thresholds for two consecutive years, it must apply the more stringent accounting and auditing rules for medium-sized companies. This would also prevent the company from using the FRSSE, but might enable it to use the IFRS for SMEs, if this were only available to medium companies. The respondents were asked if it would advantageous to extend the transition period to five years. Table 5.9 reveals that only 37% of companies were in favour and further analysis found these were more likely to be small companies rather than medium companies (chi-square 8.153; $p \leq 0.01$).

Table 5.9 Increase the transition period to five years

Response	% of companies
Yes	37
No	63
Total	100

N = 1,260

Source: Survey question 26

6 Auditing

Introduction

6.1 This chapter describes the survey results relating to auditing requirements for SMEs. The purpose of the audit is to demonstrate 'the completeness, accuracy and validity of transactions which, when aggregated, make up the financial statements' (Power, 1997, p. 24). The statutory audit must be performed by an auditor who is external to the organization.

Perceptions of the audit

6.2 To investigate perceptions of the potential benefits of external audit, all the respondents were asked to give their views on various statements on a scale of 1 to 5 (where 5 = agree and 1 = disagree, with 3 = neutral). Table 6.1 shows the main benefit of audit is the check provided on accounting systems and records (74% agreed), followed by improved internal controls and the positive effect on the company's credit rating score. However, 33% of directors considered the costs exceed the benefits.

Table 6.1 Perceptions of the audit (% of companies)

Perception	Agree			Disagree			N/R	Total
	5	4	3	2	1			
Provides a check on accounting systems and records	45	29	17	4	2	3	100	
Improves internal controls	19	25	31	13	8	4	100	
Has a positive effect on the credit rating score	17	27	32	10	8	6	100	
Improves the quality of the financial information	17	25	31	15	8	4	100	
Deters or reveals fraud by directors or employees	17	24	31	14	10	4	100	
The cost outweighs the benefits	17	16	30	20	13	4	100	

N = 1,294

Source: Survey question 6

Audit decision

6.3 The directors of 54% of the SMEs indicated that the accounts had been audited in 2006 because the company was above the audit exemption thresholds. To provide a basis for the analysis in this study, these companies were categorised as medium-sized and the remaining 46% as small. Since exemption is only available to small companies, Table 6.2 analyses the audit decision in 2006 for this group and shows that 32% had chosen a voluntary

audit for the benefits it brings to the company and a further 7% had done so because they were close to the threshold.

Table 6.2 Audit decision by small companies in 2006

Decision	% of small companies
Not audited	61
Voluntary audit	
Because there are benefits in doing so	32
Because the company was close to the threshold	7
Total	100

N = 592

Source: Survey question 7

- 6.4 To examine the factors that may have influenced the audit decision in 2006, all respondents were asked to give their views on various statements on a scale of 1 to 5 (where 5 = agree and 1 = disagree, with 3 = neutral). Table 6.3 shows the main factor was the desire for consistency with previous years (45% agreed) and this may account for only 19% acknowledging they had reviewed the costs and benefits since 2003. Almost half the directors (45%) knew whether the company had a choice. The audit decision was influenced by the needs of lenders in 44% of companies and in 33% by the needs of shareholders. Cost was a major burden for less than a quarter of the companies, and it was more likely to be considered a major burden in small rather than medium companies (chi-square 85.353; $p \leq 0.01$).

Table 6.3 Factors affecting the audit decision in 2006 (% of companies)

Factor	Agree			Disagree			N/R	Total
	5	4	3	2	1			
Consistency with previous years was a major factor	21	24	22	8	14	11	100	
We knew whether the company had a choice	29	16	24	6	11	14	100	
Bank/lenders require audited accounts	28	16	15	7	22	12	100	
Shareholders require audited accounts	20	13	17	12	25	13	100	
The cost of audit was a major burden	12	10	26	15	24	13	100	
We had reviewed the costs and benefits since 2003	8	11	29	16	22	14	100	
Major suppliers or customers require audited accounts	9	9	15	15	36	16	100	
The audit revealed fraud in the past	1	1	6	9	68	15	100	

N = 1,294

Source: Survey question 13

- 6.5 Further analysis found medium positive correlation between the directors wanting the accounts audited for the bank/lenders and because the shareholders wanted audited accounts (Spearman's ρ 0.553; $p \leq 0.01$). There was weak correlation between all other factors (apart from reviewing the costs and benefits since 2003) and having the accounts audited for lenders.
- 6.6 Small companies whose directors had chosen to have a voluntary audit in 2006 were more likely to have filed full accounts on a voluntary basis, rather than take up the option to file abbreviated accounts (chi-square 66.849; $p \leq 0.01$). Table 6.4 gives further details.

Table 6.4 Auditing and filing decisions small companies in 2006

Audit decision	Voluntary full accounts (% of small companies)	Abbreviated accounts (% of small companies)
Not audited	46	80
Voluntary audit	54	20
Total	100	100

N = 592

Source: Survey questions 20 and 7

Audit costs

- 6.7 Audit costs are easier to measure than the benefits and Table 6.5 provides a breakdown of the audit fees in 2006 by size. The data was collected in the categories shown in the table, where the mean for the whole sample was £5,001 - £10,000. Not surprisingly, further analysis found that the audit fees were likely to be lower for small companies than for medium companies (chi-square 152.490; $p \leq 0.01$).

Table 6.5 Audit fees in 2006

Audit fee	% of small companies	% of medium companies
Up to £1,000	15	1
£1,001 – £5,000	39	18
£5,001 – £10,000	29	38
£10,001 – £15,000	9	21
More than £15,000	8	22
Total	100	100

N = 928 (232 small and 696 medium)

Source: Survey question 8

6.8 It was noted in Table 6.1 that a third of the respondents considered the costs of external audit outweighed the benefits. Therefore, those who had stopped having the accounts audited since the higher exemption thresholds in 2003 were introduced were asked what effect this had had on the total accountancy fees they paid to an external accountant. Just over half the companies taking up exemption (54%) had not experienced lower total accountancy fees and in 2% of cases, fees had risen due to other services being supplied. The data was collected in the categories shown in Table 6.6, which demonstrates that among those reporting reduced fees, the amount saved was typically £5,000 or less.

Table 6.6 Effect on total accountancy fees on discontinuing the audit

Change in total accountancy fees	% of companies
No change	54
Decreased by:	
Up to £1,000	22
£1,001 – £5,000	16
£5,001 – £10,000	3
£10,001 – £15,000	3
Increased (other services)	2
Total	100

N = 161

Source: Survey question 16

Auditor independence

6.9 Companies where the accounts had been audited in 2006 were asked how long the current firm of accountants had been providing auditing services. The answers ranged from 1 to 97 years, with a mean of 12 years and a mode of 10 years, suggesting that many SMEs have longstanding relationships with their auditors. Together with the finding that in 83% of companies the 2006 statutory accounts were prepared by an external accountant (see Table 4.9), this raises the question of auditor independence. Table 6.7 reveals that in a minority of companies, the auditor was the same person who had prepared the accounts, with no significant association with size.

Table 6.7 Auditor independence in 2006

Auditor	% of companies
The same person who had prepared the accounts	22
The same firm, but not the person who had prepared the accounts	24
Someone from a different firm, not involved in preparing the accounts	54
Total	100

N = 924

Source: Survey question 9

- 6.10 The increased number of companies qualifying for audit exemption since 2004, combined with tighter guidelines on auditor independence in recent years, raises the question of whether small and medium-sized practitioners would find it uneconomic to continue providing audit services. However, the survey found that only 4% of SMEs had found it necessary to appoint a new auditor because the previous firm had stopped providing audit services.

Predicted audit decision

- 6.11 Table 6.8 shows that 57% of the directors of SMEs would still have the accounts audited even if there was no legal obligation to do so. Further analysis found that the directors of medium companies were more likely to predict they would have a voluntary audit than small companies (chi-square 160.653; $p \leq 0.01$).

Table 6.8 Predicted audit decision

Decision	% of companies
Voluntary audit	57
Not audited	43
Total	100

N = 1,277

Source: Survey question 12

Audit exemption for medium companies

- 6.12 The survey found that more than half the respondents (58%) were against extending audit exemption to medium-sized companies. Further analysis was conducted to examine the predicted audit decision among owner-managed medium companies (where all the shareholders have access to day-to-day internal financial information) if they were granted exemption from the statutory audit. The results in Table 6.9 show this would benefit just over a

quarter of companies, but the majority (73%) would continue to having an audit.

Table 6.9 Predicted audit decision by owner-managed medium companies

Prediction	% of companies
Voluntary audit	73
Not audited	27
Total	100

N = 673

Source: Survey question 12

Alternative form of assurance

6.13 To investigate the potential demand for a lesser form of assurance, all companies were asked whether they would consider a less rigorous and cheaper alternative to the audit if this were permitted. Table 6.10 reveals that 69% of SMEs were interested and further analysis found this was more likely to be small companies whose accounts had not been audited in 2006 rather than small or medium-sized companies whose accounts had been audited (chi-square 4.916; $p \leq 0.05$).

Table 6.10 Interest in an alternative form of assurance

Response	% of companies
Yes	69
No	31
Total	100

N = 673

Source: Survey question 12

7 Longitudinal analysis

Introduction

- 7.1 It was noted in Chapter 3 that among the respondents to the present study were 94 companies whose directors had also participated in the previous study (Collis, 2003). This permits a longitudinal analysis that compares their financial reporting choices in their 2002 accounts with those they made in the 2006 accounts. This provides some useful insights into the impact of raising the thresholds in 2004 on this particular group of companies.
- 7.2 It is not possible to compare the percentage results for the 94 companies in this chapter with those in the preceding chapters or those in the previous study, due to the small size of this subset and differences in the size selection criteria. The 2003 study used the EU maxima for a small company at that time, due to its focus on raising the audit exemption thresholds for small companies. On the other hand, the size limits for the present survey reflect the April 2008 EU maxima for a medium company, because this study investigates wide range of issues that are relevant to both small and medium-sized companies.

Companies in the analysis

- 7.3 This section describes the characteristics of the 94 companies included in the analysis. Table 7.1 provides a breakdown by industry and shows that this subset had activities in all sectors apart from C, E, M and N, which Table 3.1 showed had the lowest proportion of respondents.

Table 7.1 Distribution by industry

Standard Industrial Classification	% of companies
A, B Agriculture, Hunting and Forestry; Fishing	1.1
C, E Mining and Quarrying; Electricity, Gas and Water Supply	0.0
D Manufacturing	9.6
F Construction	12.8
G Wholesale and Retail Trade; Repairs	22.3
H Hotels and Restaurants	1.1
I Transport, Storage and Communication	2.1
K Real Estate, Renting and Business Activities	42.6
M Education	0.0
N Health and Social Work	0.0
O Other Community, Social and Personal Service Activities	8.4
Total	100.0

N = 94

Source: 2006 accounts

- 7.4 The large majority of companies (87%) had between one and four shareholders. In 55% of cases they were wholly family-owned (only one shareholder or all are related) and a further 22% were partly family owned. The majority of the companies (65%) can be described as owner-managed, since all their shareholders had access to day-to-day internal financial information.
- 7.5 Tables 7.2 – 7.4 compare the size of the companies in 2002 and 2006. This analysis suggests a small proportion had grown in terms of turnover, but this had led to little difference in the value of their balance sheet. Changes in number of employees are difficult to ascertain, since many of the companies no longer disclose figures.

Table 7.2 Turnover in 2002 and 2006 (% of companies)

Turnover	2002 accounts	2006 accounts
Up to £1m	68	62
£1.1m – £5m	32	30
£5.1m – £10m	0	6
£10.1m – £15m	0	1
No response	0	1
Total	100	100

N = 94

Source: 2002 accounts and survey question 17

Table 7.3 Balance sheet total in 2002 and 2006 (% of companies)

Balance sheet total	2002 accounts	2006 accounts
Up to £2.8m	100	99
£2.801m – £11.4m	0	1
Total	100	100

N = 94

Source: 2002 and 2006 accounts

Table 7.4 Average employees in 2002 and 2006 (% of companies)

Number of employees	2002 accounts	2006 accounts
1 – 50	100	50
51 – 250	0	3
None/Not available	0	47
Total	100	100

N = 94

Source: 2002 and 2006 accounts

- 7.6 Table 7.5 gives a breakdown of the companies according to their age at the time of the 2006 accounts. Not surprisingly, the majority were over 5 years old, since they had been in existence long enough to have filed accounts in 2002 and nearly half (48%) were up to 15 years old.

Table 7.5 Age in 2006

Number of years	% of companies
Up to 5	3
6 – 10	23
11 – 15	22
16 – 20	15
21 – 25	14
More than 25	23
Total	100

N = 94

Source: 2006 accounts

- 7.7 Descriptive statistics for key financial indicators for the 94 companies are presented in Table 7.6. The QuiScore measures the likelihood of company failure in the following year and is based on a scale of 0 to 100 (where 1–20 =

high risk; 21–40 = caution; 41–60 = normal; 61– 80 = stable; and 81–100 = secure). It was noted in Chapter 4 that the ratios are industry sensitive and therefore caution should be taken when drawing conclusions based on the mean.

Table 7.6 Key financial indicators in 2006

Indicator	N	Min	Max	Mean	SD
Profit margin (%)	66	-60	69	13.66	21.565
Return on capital employed (ROCE) (%)	67	-334	808	34.29	131.222
Return on shareholders' funds (%)	67	-334	808	30.88	136.832
Liquidity (ratio:1)	89	<1	55	3.27	7.769
Gearing (%)	60	0	2,968	117.30	391.213
QuiScore	91	19	94	63.43	18.658

Source: FAME

- 7.8 Table 7.7 illustrates the range and extent of sources of external finance used in 2006 and shows that the main sources were directors' loans (34%) and borrowings from financial institutions (33%). Hire purchase or leasing was used by 23%.

Table 7.7 External sources of finance in 2006

Source	% of companies
Director's loans	34
Loans and mortgages from banks/other financial institutions	33
Hire purchase or leasing	23
Forward payments from customers	9
Debt factoring or invoice discounting	5
Loans from family and friends	5
Debentures	2
Loans from company pension funds	1

N = 94

Source: Survey question 3 (more than one response was possible)

- 7.9 Table 7.8 shows the range of services received from external accountant(s) in 2006. The large majority of companies employed an external accountant to prepare the statutory accounts for shareholders and Companies House (77%) and 48% received advice on the relevant financial reporting regulations. However, only 53% used external accountants for their tax accounts.

Table 7.8 Services from external accountant(s) in 2006

Service	% of companies
Preparing statutory accounts for shareholders and Companies House	77
Preparing accounts for the tax authorities	53
Advice on accounting/auditing regulations	48
Additional detailed annual accounts for management's use	15
General advice on running a company	15
Management advice in connection with the annual results	14
Bookkeeping or preparing periodic management accounts	14
Preparing accounts for the bank/lenders	13
Advice on raising finance	6
Preparing accounts for major suppliers or customers	2

N = 94

Source: Survey question 4 (more than one response was possible)

Accounting

7.10 In 2002, all 94 companies had filed full accounts. Based on their audit decision that year (see Table 7.13), 73% of the companies were categorised as small for the purposes of the research. Therefore, they must have filed full accounts on a voluntary basis in 2002. However, by 2006, half the companies were filing abbreviated accounts. Table 7.9 gives further details.

Table 7.9 Filing decision in 2002 and 2006 (% of companies)

Decision	2002 accounts	2006 accounts
Full accounts		
Statutory full accounts (above the size thresholds)	27	22
Voluntary full accounts (small or medium company)	73	28
Abbreviated accounts (small or medium company)	0	50
Total	100	100

N = 94 (size deduced from their audit decision in the relevant year)

Source: Survey data

7.11 Table 7.10 shows that consistency with previous years was a factor influencing the type of accounts filed by 68% of respondents, but the switching behaviour noted in the previous table suggests that it is not necessarily an overriding factor. The majority of directors (61%) knew whether the company had a choice of filing options and 36% had reviewed the costs and benefits since 2003. Nearly half the directors (47%) were of the opinion that their published accounts are useful to users.

Table 7.10 Factors affecting the filing decision in 2006 (% of companies)

Statement	Agree	Disagree	N/R	Total
Consistency with previous years was a major factor	68	28	4	100
We knew whether the company had a choice	61	26	14	100
Disclosing annual accounts is the 'price' paid for limited liability	55	34	11	100
Our accounts at Companies House are useful to users	47	42	11	100
We had reviewed the costs and benefits since 2003	36	49	15	100
The cheapest option was a major factor	30	59	11	100
Disclosing turnover is/would be a major disadvantage	21	67	12	100
Our accounts are also on our website	3	85	12	100
We only file full accounts when the results are good	2	85	13	100

N = 94

Source: Survey data

- 7.12 Not surprisingly, the main recipients of the 2006 accounts (apart from shareholders and Companies House) were the providers of finance and the tax authorities. Table 7.11 gives further details.

Table 7.11 Recipients of the 2006 accounts

Recipient	% of companies
The bank and other lenders	45
Tax authorities	45
Directors or other employees who are <u>not</u> shareholders	21
Major customers	5
Major suppliers and trade creditors	4
Credit rating agencies	2
Industry regulators (eg FSA, CAA, ABTA)	2

N = 94

Source: Survey question 5 (more than one response was possible)

- 7.13 In both surveys, the directors were asked whether the accounts had been prepared using the Financial Reporting Standard for Smaller Entities (FRSSE). Table 7.12 compares the responses of the small companies and shows that 73% used the FRSSE in 2002 compared to 81% for the 2006

accounts. As noted in Chapter 5, care must be taken when drawing conclusions from this data, as non-accountants may not have been familiar with this accounting standard.

Table 7.12 Use of the FRSSE in 2002 and 2006 (% of small companies)

Decision	2002 accounts	2006 accounts
Used the FRSSE	73	81
Did not use the FRSSE	27	19
Total	100	100

N = 66 in 2002 and 74 in 2006

Source: Survey data

Auditing

7.14 In both surveys, the directors were asked whether the company's latest accounts had been audited. The increase in the turnover threshold for audit exemption from 2004 (raised from £1 million to £5.6 million), seems to have made little difference to their audit decisions made by these 94 companies in 2006, since Table 7.13 shows that the proportion filing non-audited accounts was almost unchanged.

Table 7.13 Audit decision in 2002 and 2006 (% of companies)

Decision	2002 accounts	2006 accounts
Audited		
Statutory audit	27	19
Voluntary audit (small company)	27	33
Not audited (small company)	46	48
Total	100	100

N = 94

Source: Survey data

7.15 Table 7.14 examines the factors influencing the audit decision in 2006 on a rating scale of 1 to 5 (where 5 = agree and 1 = disagree, with 3 = neutral). The results show that 53% knew whether the company had a choice and the main factor was the desire for consistency with previous year (50% agreed). This supports the results in the previous table. Just over a quarter (28%) agreed that they had reviewed the costs and benefits since 2003, with a similar proportion agreeing that the cost of audit was a major burden.

Table 7.14 Factors affecting the audit decision in 2006 (% of companies)

Factor	Agree		Disagree			N/R	Total
	5	4	3	2	1		
We knew whether the company had a choice	37	16	18	5	10	14	100
Consistency with previous years was a major factor	31	19	22	5	12	11	100
We had reviewed the costs and benefits since 2003	13	15	32	9	18	13	100
The cost of audit was a major burden	15	13	23	14	21	14	100
Shareholders require audited accounts	18	6	19	12	29	16	100
Bank/lenders require audited accounts	16	1	23	9	35	16	100
Major suppliers or customers require audited accounts	4	3	12	14	48	19	100
The audit revealed fraud in the past	1	0	7	6	69	16	100

N = 94

Source: Survey question 13

7.16 Table 7.15 shows that in 2003, 54% of these companies predicted they would continue to have the accounts audited if the thresholds were raised. The reliability of this prediction is confirmed by their decision in 2006, where 52% of companies stated that their accounts had been audited (see Table 7.10). The present study found that 48% of respondents would choose a voluntary audit in future if exempt from the statutory audit, which supports the finding that consistency with previous years is a major factor for many companies (see Table 7.10).

Table 7.15 Predicted audit decision in 2003 and 2007 (% of companies)

Prediction	2003 survey (Collis, 2003)	2007 survey (Collis, 2008)
Audited	54	48
Not audited	46	52
Total	100	100

N = 94 (sized deduced from their audit decision in the relevant year)

Source: Survey data

8 Discussion and conclusions

Evaluation of the research design

- 8.1 Using a large-scale postal questionnaire survey, this study has examined the practices and views of the directors of SMEs in the UK in the context of recent changes and proposed developments in the regulation of financial reporting by smaller companies. The views of the directors are important, because they bear the administrative and cost burdens of compliance, which the European Commission and the UK government would like to reduce. However, the research has some limitations and consultation is needed with other stakeholders, such as small accountancy practices providing services to SMEs, lenders, creditors and users of the published financial statements.
- 8.2 The sample consisted of 1,294 non-publicly accountable private limited companies in the UK and Northern Ireland and across all industries (apart from financial intermediation) that had filed their 2006 accounts at the time of the study. They were selected from the FAME database using a maximum balance sheet total of £12.9 million and up to 250 employees, which means the sample includes small and medium-sized entities (SMEs). The exclusion of turnover in the above criteria ensured that companies filing either full or abbreviated accounts were selected.
- 8.3 One of the objectives of the research was to update the findings of a survey in 2003, which had been commissioned by the then DTI to investigate views of small companies on raising the turnover threshold for audit exemption from £1 million to £4.8 million. Therefore, the actual and predicted practices from that study were based on companies with a maximum turnover of £4.8 million. In the eventuality, the threshold for a small company was raised to £5.6 million in 2004 (see Chapter 2) and to £6.5 million in 2008. Thus, the present study's category of 'small' companies includes an additional tranche of companies, which may previously have been classed as 'medium'. Therefore, their views would not have been represented in the 2003 predictions and this makes it difficult to contrast the results of the two studies.
- 8.4 As the sampling frame (FAME) does not fully represent companies with a turnover of less than £0.5 million, and there was a poor response from very small entities, the findings of this research may not be generalisable to the smallest companies. The difficulty of capturing the views of the very small companies makes comparison with the statistics produced by Companies House difficult. In addition, care must be taken when comparing studies, as there is no definitive list of companies that qualify as 'small' or 'medium' at any moment in time. Moreover, size is a dynamic concept that changes over time and studies must be interpreted in the context of the thresholds in force at the time and the way in which the researchers have chosen to define size.

Main accounting results

- 8.5 Previous studies of small companies provide evidence that over 80% use an external accountant to prepare their statutory accounts (Collis and Jarvis, 2000; Collis, 2003). The present study extends this to SMEs, as the results show that the vast majority (83%) had used an external accountant to prepare their 2006 accounts.
- 8.6 Companies that qualify as small or medium are given the option of filing abbreviated accounts and most of the respondents (60%) knew whether they had a choice. The majority (68%) had filed full accounts in 2006, whilst 32% had filed abbreviated accounts. This must be interpreted in the context that the sample was not representative of the smallest companies, which are likely to have chosen this option. In 21% of companies, the directors had filed full accounts on a voluntary basis because the directors considered there were benefits for the company. However, in 4% of cases, it was because the company was close to the thresholds. This suggests that a small proportion of companies would be relieved of a burden if thresholds were raised to a point where they were not likely to traverse them and/or the transition period for SMEs crossing the thresholds were increased from two to five years (see paragraph 8.13).
- 8.7 The main factor influencing the directors' filing decisions in 2006 were a desire for consistency with previous years (65%) and the underlying reasons for this require further investigation. Cost was a major factor for 21% of respondents and this is similar to the proportion that considered the cost of audit was a major burden.
- 8.8 More than half the directors (56%) considered the published accounts are useful to users, but identifying the actual users of the accounts registered at Companies House was beyond the scope of the study. The directors believed the user groups are those who need information for assessing credit risk (64% cited suppliers and other trade creditors; 62% cited credit rating agencies) and/or lending risk (46% cited banks and other lenders). These groups were also identified as direct recipients of the accounts. Interestingly, only 57% of respondents thought competitors were using the published accounts. Information about the potential users of the published accounts is important because these external parties are those whose needs the directors have in mind when deciding their auditing and accounting policies.
- 8.9 During the Company Law Review in the UK, the Steering Committee proposed that in order to improve the usefulness of the accounts, SMEs 'should no longer be able to file uninformative "abbreviated" accounts' (DTI, 2001, p. 3). This would have meant that companies of all sizes would have been required to disclose turnover data. The present study found 58% agreed that disclosing annual accounts is the 'price' paid for having limited liability, but only 22% considered disclosing turnover would be a major disadvantage. This implies that this disclosure burden is not a major problem for the majority

of SMEs and is supported by the evidence that a large proportion of the sample filed full accounts on a voluntary basis.

- 8.10 There was support for the European Commission's draft proposal to exempt micro entities from the statutory filing requirement (EC, 2007a; EC, 2008), with 33% of directors in favour. In addition, 18% supported exemption for both micro entities and small companies, and a further 14% were in favour of this concession for all SMEs. This requires further investigation in the context of the usefulness of the published accounts to external parties.
- 8.11 The directors of 69% of small companies had adopted the FRSSE as the basis for preparing their 2006 accounts, rather than the full range of UK accounting standards. However, respondents who were not familiar with accounting standards may not have verified the information they gave.
- 8.12 A quarter of the directors considered the IFRS for SMEs (Private Entities) would be beneficial if it aided comparability for foreign users of the company's accounts. The directors of medium companies, rather than small companies, were more likely to consider the draft IFRS an advantage. This may also reflect the fact that small companies already have the FRSSE in the UK, whereas medium-sized companies are required to use the full range of accounting standards at present. These findings contribute to the international debate on which groups of non-publicly accountable entities might benefit from using this new international accounting standard.
- 8.13 There was little support for the European Commission's draft proposal to extend the transition period for SMEs crossing the thresholds from two to five years (EC, 2007a), with 63% of directors against such a change. Small companies rather than medium companies were more likely to support the proposal and further research is needed to investigate their needs.

Main auditing results

- 8.14 The directors of 54% of the companies indicated that the company was above the audit exemption threshold in 2006. To provide a basis for the analysis in this study, these companies were categorised as medium-sized and the remaining 46% as small. The accounts of 61% of the small companies had not been audited in 2006, but the directors of 32% had chosen a voluntary audit because they considered there were benefits for the company in doing so. However, in 7% of cases the accounts were audited because the company was close to the thresholds. This suggests that a small proportion of companies would be relieved of a burden if thresholds were raised to a point where they were not likely to traverse them.
- 8.15 Previous research (Collis, 2003; Collis, Jarvis and Skerratt, 2004) found evidence of the agency role played by audited accounts (Jensen and Meckling, 1976) in supporting relationships between the directors and external principals in small companies (Power, 1997). The present research extends

this to SMEs. Although the main factor influencing the 2006 audit decision in for the SMEs was the desire for consistency with previous years (45% agreed), 44% cited demand from the bank/lenders and 33% cited demand from shareholders. A related finding is that 45% of the SMEs had one or more shareholders who did not have access to day-to-day internal financial information.

- 8.16 There was wide agreement that the main benefit of external audit was the check on accounting systems and records (74% of respondents agreed). The cost of having the accounts audited was seen as a major burden by 22% and this was more likely to be small rather than medium companies. However, more than half of the companies whose directors had discontinued the audit since 2003 (54%) reported no difference in their total accountancy fees. The reasons for this offer scope for further investigation, but case study evidence from previous research (Marriott, Collis and Marriott, 2006) suggests the amount saved may have been offset by a re-apportioning of the fees for accounts preparation or the provision of additional services. Among those reporting decreased fees, the amount saved was typically £5,000 or less.
- 8.17 Only 4% of SMEs had needed to appoint a new auditor since 2003 because the previous firm had stopped providing this service. This implies that the tightening of the rules on auditor independence has not had a significant impact in the short term. However, this requires further investigation with SMEs and their auditors.
- 8.18 At present, audit exemption is only available to qualifying small companies. However, if medium companies became exempt, the survey found that 57% of these SMEs would have a voluntary audit. Indeed, 58% stated that they were against extending audit exemption to medium-sized companies. The European Commission has suggested that audit exemption might be offered to owner-managed medium companies. However, the results of this study indicate that only 27% of closely held medium companies would find this relieved administrative burdens and the remaining 73% would have a voluntary audit.
- 8.19 The Professional Oversight Board has recommended the accountancy bodies develop an accountant's report that would bridge the gap between audited and non-audited accounts (POB, 2006). They suggest the report should include a broad description of the scope of engagement of the professional accountant in the preparation of the accounts and a positive description of the accountant's professional obligations. Interest in a less rigorous and cheaper alternative to the audit was shown by 69% of directors, and this was more likely to be in small companies whose accounts were not audited in 2006. This demonstrates a potentially large demand for a lesser form of assurance from companies not wanting an audit and investigation into the particular needs of such companies offers a fruitful area for further research.

Contribution of the study

- 8.20 By focusing on a wide range of accounting and auditing issues, the results of this study contribute to the knowledge base by updating and extending previous policy-based research in the UK (in particular, Collis and Jarvis, 2000; Collis, 2003; Collis, Jarvis and Skerratt, 2004; Marriott, Collis and Marriott, 2006, POB, 2006). It reports the views of the directors on the present financial reporting options and provides an exploratory analysis of options put forward by European Commission for consultation and discussion.
- 8.21 Companies House statistics show that the majority of SMEs take up the financial reporting concessions available to them, but this survey suggests a significant proportion of directors believe there are benefits in following the rules for larger entities. Therefore, further simplification of accounting and auditing rules is unlikely to assist them unless their circumstances change. The study demonstrates that consistency with previous years is one of the driving forces behind the directors' financial reporting decisions and that cost is a major factor in only a minority of companies. These results suggest that most companies are likely to maintain their current pattern of financial reporting behaviour in the short term, whilst a small proportion may benefit from reduced cost burdens as thresholds rise.
- 8.22 The results in connection with the directors' views on the European Commission's draft proposals for simplifying the rules for SMEs can be summarised and compared with the views expressed by those sending comment letters to the Commission as follows:
- 33% of SMEs supported the notion of exempting micro entities from the requirement to register accounts (compared to 80% of commentators)
 - 35% of SMEs disagreed with the notion of exempting small entities from the requirement to publish their accounts (compared to a small majority of commentators)
 - 42% of SMEs were in favour of extending audit exemption to medium-sized entities in general, but the directors of 73% of owner-managed medium companies predicted they would continue to have the accounts audited (commentators' views were divided on this subject)
 - 63% of SMEs were against increasing the transition period for crossing the size thresholds from two to five years (compared to a small majority of commentators).
- 8.23 In conclusion, this research contributes to BERR's strategic priorities in connection with better regulation and reducing administrative burdens within the Corporate and Insolvency Activity Framework. It should also be of interest to the Financial Reporting Council, the European Commission and the International Accounting Standards Board.

References

APB (2006) *The Special Auditor's Report on Abbreviated Accounts in the United Kingdom*, Bulletin 2006/3, 3 April, London: Auditing Practices Board.

ASB (1999) *Statement of Principles for Financial Reporting*, December, London: Accounting Standards Board.

ASB (2005) *Financial Reporting Standard for Smaller Entities (effective January 2005)*, London: Accounting Standards Board.

Barker, P. C. and Noonan, C. (1996) *Small Company Compliance with Accounting Standards*, Dublin: Dublin City University Business School.

BERR (2007) *Small and Medium-Sized Enterprise (SME) Statistics for the UK 2006*, URN 07/92. Available from <http://stats.berr.gov.uk/ed/sme>

Bolton Committee (1971) *Report of the Committee of Inquiry on Small Firms*, Cmnd. 4811, London: HMSO.

Cabinet Office (1999) *Professional Policy Making for the Twenty-First Century*, London: Cabinet Office.

Carsberg, B. V., Page, M. J., Sindall, A. J. and Waring, I. D. (1985) *Small Company Financial Reporting*, London: Prentice Hall International.

CIMA (1996) *Management Accounting Official Terminology*, London: The Chartered Institute of Management Accountants.

Collis, J. (2003b) *Directors' Views on Exemption from the Statutory Audit*, URN 03/1342, London: DTI, October. Available from <http://www.berr.gov.uk/files/file25971.pdf>

Collis, J. and Jarvis, R. (2000) *How owner-managers use accounts*, Research report, London: ICAEW. Available from <http://www.icaew.com/index.cfm?route=111138>

Collis, J., Jarvis, R. and Skerratt, L. (2004) 'The Demand for the Audit in Small Companies in the UK', *Accounting and Business Research*, 34 (2), pp. 87-100.

Curran, J. and Blackburn, R. A. (2001) *Researching the Small Enterprise*, London: Sage.

DTI (2001) *Modern Company Law for a Competitive Economy, Small Business Summary*, Company Law Review Steering Group, URN 01/996, July 26, London: Department of Trade and Industry.

EC (2006) *Think small first*. Available from <http://ec.europa.eu/enterprise/smes>

EC (2007a) *Communication from the Commission on a simplified business environment for companies in the areas of company law, accounting and auditing*, Brussels: European Commission. Available from http://ec.europa.eu/internal_market/company/simplification/index_en.htm

EC (2007b) *Synthesis of the reactions received to the Commission communication on a simplified business environment for companies in the areas of company law, accounting and auditing*, Brussels: European Commission. Available from http://ec.europa.eu/internal_market/company/simplification/index_en.htm

EC (2008) 'McCreevy announces major initiatives on accounting rules for small businesses', MEMO/08/589. Available from <http://europa.eu/rapid/pressReleasesAction.do?reference=MEMO/08/589&format=HTML&aged=0&language=EN&guiLanguage=en>

IASB (1989) *Framework for the Preparation and Presentation of Financial Statements*, September, London: International Accounting Standards Committee.

IASB (2007) *Exposure Draft IFRS for Small and Medium sized Entities (ED)*, London: International Accounting Standards Board. Available from <http://www.iasb.org>

ICAEW (1996) *Information for Members: The Needs of Small and Medium Sized Businesses*, London: Institute of Chartered Accountant in England & Wales.

Jensen, M. C. and Meckling, W. H. (1976) 'Theory of the Firm: Managerial Behavior, Agency Costs and the Ownership Structure', *Journal of Financial Economics*, 3, pp. 305-360.

Krejcie, R. V. and Morgan, D. W. (1970) 'Determining Sample Size for Research Activities', *Educational and Psychological Measurement*, 30, pp. 607-610.

Marriott, N, Collis, J. and Marriott, P. (2006) *Qualitative review of the accounting and auditing needs of small and medium-sized companies and their stakeholders*, London: Professional Oversight Board. Available from <http://www.frc.org.uk/documents/pagemanager/poba/Case%20studies%20report.pdf>

Milne, T. and Thomson, M. (1986) 'Patterns of Successful Business Start Up', in Faulkner, T., Gower, G., Lewis, J. and Gibbs, A. (Eds.), *Readings in Small Business*, London: Gower.

Oxford Dictionary of Accounting (2005) (3rd edition) Oxford: Oxford University Press.

Page, M. J. (1984) 'Corporate Financial Reporting and the Small Independent Company', *Accounting and Business Research*, 14 (55), pp. 271-282.

POB (2006) *Review of how accountants support the needs of small and medium-sized companies and their stakeholders*, March, London: Professional Oversight Board.

Poutziouris, P., Chittenden, F. and Michaelas, N. (1998) *The Financial Affairs of Private Companies*, Liverpool: Tilney Fund Management.

Power, M. (1997) *The Audit Society – Rituals of Verification*, Oxford: OUP.

PricewaterhouseCoopers (1999) *Student's Manual of Accounting* (London: International Thomson Business Press).

SBS (2002) *Small and Medium Enterprise (SME) Statistics for the United Kingdom, 2001*, London: Small Business Service.

Storey, D. J. (1994) *Understanding the Small Business Sector*, London: Routledge.

Appendix 1 – Accounts exemption thresholds from April 2008

The following summary is reproduced from the following web address:

<http://www.companieshouse.gov.uk/companiesAct/implementations/apr2008ExemptionThreshold.shtml>

Companies Act 2006

Accounts Exemption Thresholds *for companies with accounting periods starting on or after 6th April 2008*

Small company

To be a small company, at least two of the following conditions must be met:

- Annual turnover must be £6.5 million or less
- The balance sheet total must be £3.26 million or less
- The average number of employees must be 50 or fewer

Small group

To qualify as small, a group of companies must meet at least two of the following conditions:

- Aggregate turnover must be £6.5 million net (or £7.8 million gross) or less
- The aggregate balance sheet total must be £3.26 million net (or £3.9 million gross) or less
- The aggregate average number of employees must be 50 or fewer

Total audit exemption

To qualify for total audit exemption, a company must:

- Qualify as small
- Have a turnover of not more than £6.5 million
- Have a balance sheet total of not more than £3.26 million

Medium-sized company

To be a medium-sized company, at least two of the following conditions must be met:

- Annual turnover must be £25.9 million or less
- The balance sheet total must be £12.9 million or less
- The average number of employees must be 250 or fewer

Medium-sized group

To qualify as medium-sized, a group of companies must meet at least two of the following conditions:

- Aggregate turnover must be £25.9 million net (or £31.1 million gross) or less
- The aggregate balance sheet total must be £12.9 million net (or £15.5 million gross) or less
- The aggregate average number of employees must be 250 or fewer

Appendix 2 – The questionnaire

«ID»

Kingston University London

***Directors' Views on
Accounting and Auditing Requirements
in Company Law***

Commissioned by

**DEPARTMENT FOR BUSINESS
ENTERPRISE & REGULATORY REFORM**

September 2007

Directors' Views on Accounting and Auditing Requirements for SMEs

*Your participation in this research is greatly appreciated.
Neither your name, nor that of your company will be associated with your responses.*

BACKGROUND INFORMATION

- Q1 How many shareholders does the company have? (Write number in box)**
- 1.1 Total number of shareholders
- Breakdown:*
- 1.2 Shareholders with access to day-to-day internal financial information
- 1.3 Shareholders without access to day-to-day internal financial information
-
- Q2 Is the company a family-owned business? (Tick one box)**
- Yes, partly family-owned (some shareholders are related) (1)
- Yes, wholly family-owned (only 1 shareholder or all are related) (2)
- No (none are related) (0)
-
- Q3 Which of the following sources of finance was the company using in 2006?**
(Tick as many as apply)
- 3.1 Loans (including mortgages) from banks and other financial institutions
- 3.2 Loans from family and friends
- 3.3 Directors' loans
- 3.4 Loans from company pension funds
- 3.5 Hire purchase or leasing
- 3.6 Debt factoring or invoice discounting
- 3.7 Forward payments from customers
- 3.8 Debentures
- 3.9 Venture capital or business angel finance
-
- Q4 Did the company receive any of the following services from external accountant(s) in 2006?**
(Tick as many as apply)
- 4.1 Preparing the statutory accounts for shareholders and Companies House
- 4.2 Advice on accounting/auditing regulations that affect the company
- 4.3 Additional detailed annual accounts for management's use
- 4.4 Management advice in connection with the annual results
- 4.5 Preparing accounts for the bank and other lenders
- 4.6 Preparing accounts for major suppliers or major customers
- 4.7 Preparing accounts for the tax authorities
- 4.8 Bookkeeping or preparing weekly/monthly/quarterly management accounts
- 4.9 Advice on raising finance
- 4.10 General advice on running a company
-
- Q5 Apart from the shareholders and Companies House, who normally receives a copy of the company's accounts? (Tick as many as apply)**
- 5.1 Directors or other employees who are not shareholders
- 5.2 The bank and other lenders
- 5.3 Major suppliers and trade creditors
- 5.4 Major customers
- 5.5 Tax authorities
- 5.6 Industry regulator (eg FSA, CAA, ABTA)
- 5.7 Credit rating agencies

Directors' Views on Accounting and Auditing Requirements for SMEs

AUDITING

Q6 Whether the company's 2006 accounts were audited or not, what are your views on the following statements regarding the audit? (Circle number closest to your view)

		Agree		Disagree		
6.1	Provides a check on accounting systems and records	5	4	3	2	1
6.2	Improves internal controls	5	4	3	2	1
6.3	Improves the quality of the financial information	5	4	3	2	1
6.4	Has a positive effect on the credit rating score	5	4	3	2	1
6.5	Deters or reveals fraud by directors or employees	5	4	3	2	1
6.6	The cost of auditing outweighs the benefits	5	4	3	2	1

Q7 Were the company's 2006 accounts audited? (Tick one box)

- Yes, because the company was above the size thresholds (1)
- Yes, on a voluntary basis as the company was close to the size limit (2)
- Yes, on a voluntary basis as there are benefits in doing so (3)
- No, the company was exempt (If you tick this box, go to Q12) (0)

Q8 If the 2006 accounts were audited, how much was the audit fee? (Tick one box)

- Up to £1,000 (1)
- £1,001 - £5,000 (2)
- £5,001 - £10,000 (3)
- £10,001 - £15,000 (4)
- More than £15,000 (5)
- Don't know (0)

Q9 If the 2006 accounts were audited, who carried out the audit? (Tick one box)

- The same person who prepared the accounts (1)
- Someone from the same firm, but not the person preparing the accounts (2)
- Someone from a different firm not involved in preparing the accounts (3)

Q10 How long has this firm of accountants been auditing the company's accounts?

Number of years

Q11 Has the company had to find a new auditor since 2003 because the previous accountant stopped providing external auditing services?

- Yes (1)
- No (0)

Q12 Would the accounts be audited in future if there were no legal reason for doing so?

- Yes (1)
- No (0)

Directors' Views on Accounting and Auditing Requirements for SMEs

Q13 What are your views on the following statements in connection with the decision on whether or not to have the 2006 accounts audited? (Circle number closest to your view)

		Agree			Disagree		
13.1	Consistency with previous years was a major factor	5	4	3	2	1	
13.2	We had reviewed the costs and benefits since 2003	5	4	3	2	1	
13.3	We knew whether the company had a choice	5	4	3	2	1	
13.4	The shareholders require audited accounts	5	4	3	2	1	
13.5	The bank/lenders require audited accounts	5	4	3	2	1	
13.6	Major suppliers or customers require audited accounts	5	4	3	2	1	
13.7	The audit revealed fraud in the past	5	4	3	2	1	
13.8	The cost of the audit was a major burden	5	4	3	2	1	

Q14 If allowed, would you consider a less rigorous and cheaper alternative to the audit?

Yes (1)
No (0)

Q15 Has the company stopped having the accounts audited since 2003?

(Go to Q16) Yes (1)
(Go to Q17) No (0)

Q16 If the company has stopped having an audit since 2003, by how much have the external accountant's fees decreased? (Tick one box)

No change (1)
Decreased by up to £1,000 (2)
Decreased by £1,001 - £5,000 (3)
Decreased by £5,001 - £10,000 (4)
Decreased by £10,001 - £15,000 (5)
Decreased by more than £15,000 (6)
Increased due to other accountancy services (7)
Don't know (0)

Q17 What was the company's turnover for the year ending in 2006? (Tick one box)

Up to £1m (1)
£1.1m - £5m (2)
£5.1m - £10m (3)
£10.1m - £15m (4)
£15.1m - £20m (5)
£20.1m - £25m (6)
£25.1m - £30m (7)
More than £30m (8)
Don't know (0)

Q18 At present, audit exemption is only available to small companies (0 – 50 employees). Do you think audit exemption should also be made available to medium-sized companies (0 – 250 employees)?

Yes (1)
No (0)

Directors' Views on Accounting and Auditing Requirements for SMEs

ACCOUNTS FOR FILING AT COMPANIES HOUSE

Q19 How many weeks after the end of your financial year did the company receive the 2006 accounts from the accountant? Number of weeks

Q20 Did the company file full accounts at Companies House in 2006? *(Tick one box)*

Yes, the company was above the size thresholds (1)
 Yes, on a voluntary basis as the company was close to the size thresholds (2)
 Yes, on a voluntary basis for other reasons (3)
 No, the company filed abbreviated accounts (0)

Q21 What are your views on the following statements in connection with the type of accounts filed at Companies House in 2006? *(Circle number to indicate your view)*

		Agree	Disagree
21.1	Consistency with previous years was a major factor	1	0
21.2	We had reviewed the costs and benefits since 2003	1	0
21.3	We knew whether the company had a choice	1	0
21.4	We only file full accounts when the results are good	1	0
21.5	Our accounts at Companies House are useful to users	1	0
21.6	The accounts we file at Companies House are on our website	1	0
21.7	The cheapest option was a major factor	1	0
21.8	Disclosing turnover is/would be a major disadvantage	1	0
21.9	Disclosing annual accounts is the 'price' paid for limited liability	1	0

Q22 In Q5 you indicated who receives a copy of the company's accounts. Do you know who may be using the accounts you file at Companies House? *(Tick as many as apply)*

22.1	Potential investors or acquirers	<input type="checkbox"/>
22.2	Directors or other employees who are <u>not</u> shareholders	<input type="checkbox"/>
22.3	The bank and other lenders	<input type="checkbox"/>
22.4	Suppliers and trade creditors	<input type="checkbox"/>
22.5	Customers	<input type="checkbox"/>
22.6	Government departments and agencies	<input type="checkbox"/>
22.7	Members of the public	<input type="checkbox"/>
22.8	Competitors	<input type="checkbox"/>
22.9	Credit rating agencies	<input type="checkbox"/>

Q23 Do you think some private limited companies should be exempt from the requirement to file accounts? *(Tick one box)*

Yes, micro entities (0 – 9 employees) (1)
 Yes, micro and small entities (0 - 50 employees) (2)
 Yes, micro, small and medium entities (0 - 250 employees) (3)
 No (0)

Directors' Views on Accounting and Auditing Requirements for SMEs

ACCOUNTING STANDARDS

Q24 Were the 2006 accounts prepared using the Financial Reporting Standard for Smaller Entities? (*This is shown in the directors' report on the accounts*)

Yes (1)
No (0)

Q25 Would it be an advantage to your company to be allowed to prepare the statutory accounts using the new international financial reporting standard for private companies instead of the one mentioned above? (*This could aid comparability for overseas users of the company's accounts and is based on the standard terms and methods of measurement now used by large companies in the EU and many other countries.*)

Yes (1)
No (0)

AND FINALLY...

Q26 If a small company exceeds the size thresholds for 2 consecutive years, it must apply the more stringent accounting and auditing rules for medium-sized companies. Would it be an advantage to your company if this were increased to 5 years?

Yes (1)
No (0)

Q27 What is your position in the company? (*Tick one box*)

Company secretary, finance director, managing director or other director (1)
Company accountant (2)
Manager (3)
Other (*please state*)..... (4)

Q28 Would you like a summary of the findings when the research is published?

If so, please give your email address:

.....

The Government's consultation document on the simplification of accounting and auditing is available electronically from: debbie.jones@berr.gsi.gov.uk

*Thank you very much for taking part in this important survey.
Please return your completed questionnaire in the prepaid envelope
as soon as soon as possible to*

Collis 2007 Survey
Silverhill, Rudgeway, Bristol BS35 3NS

If you have any queries about this survey, you can email me at j.collis@kingston.ac.uk