HARMONISING USER NEEDS WITH REPORTING REQUIREMENTS OF CLOSE CORPORATIONS

RENSHIA KRUGER

HARMONISING USER NEEDS WITH REPORTING REQUIREMENTS OF CLOSE CORPORATIONS

BY

RENSHIA KRUGER

THESIS SUBMITTED IN FULFILMENT OF THE REQUIREMENTS FOR THE DEGREE

MAGISTER IN ACCOUNTING

IN THE

FACULTY OF ECOMOMIC AND MANAGEMENT SCIENCES
(DEPARTMENT OF ACCOUNTING)

AT THE
UNIVERSITY OF FREE STATE

PROMOTER: PROF H.A. VAN WYK

BLOEMFONTEIN
NOVEMBER 2004

ACKNOWLEDGEMENTS

First and foremost I thank my Creator for providing me with the necessary attributes to reach this achievement. Without His constant presence in my life, the completion of this thesis would not be possible.

I would also like to express my gratitude to my promoter prof. Hentie van Wyk for providing me with the necessary guidance and support in order to successfully complete this thesis.

Thank you to my family for all their encouragement and moral support and special thanks to my farther for all the help provided in printing and binding the proof copies.

Also thanks to me. Valerie Hanekom for the technical care of this thesis. The effort put into it is sincerely appreciated.

TABLE OF CONTENTS

TABLE OF CONTENTS (continued)

TABLE OF CONTENTS (continued)

TABLE OF CONTENTS (continued)

LIST OF FIGURES

LIST OF TABLES

LIST OF GRAPHS

DEFINITIONS OF TERMS USED

Accounting standards overload

The situation in which the benefits of the required information to the users of the financial statements of a business do not exceed their cost.

Business entity

Any natural or legal person who carries on business or any group of persons who jointly carry on business (Van Dorsten 1991:3).

Close Corporation

An alternative corporate form for a business venture in South Africa, governed by the Close Corporations Act No. 69 of 1984.

Entity

A set of resources (or assets) employed for a common purpose - such assets being owned, and liabilities owned, by one person, or by two or more persons associated for the common purpose aforesaid (Lee 1973:2).

General purpose financial reporting standards

Financial reporting standards set for the preparation and presentation of the financial statements of an entity where -

(a) any users of the financial statements of the entity have to rely mainly or solely on those financial statements for financial information regarding the entity; or

(b) the entity receives deposits or loans from members of the general public or where the securities of the entity are issued to members of the general public (SAICA 2002:4).

Limited purpose financial statements

Financial statements that are distributed to a limited range of users who have an interest in the affairs of the enterprise and are thus in a position to call for further information or have the right to call for further information (SAICA 2001:2).

Limited purpose financial reporting standards

Financial reporting standards set for the preparation and presentation of financial statements of an entity where -

(a) there are no users of those financial statements of a class as contemplated in the definition of "general purpose financial reporting standards"; or

(b) all of the users of those financial statements as contemplated in the definition of "general purpose financial reporting standards" have waived, in accordance with a relevant act, their right to receive financial statements complying with general purpose financial reporting standards and have consented to the issuing to them of financial statements complying with limited purpose financial reporting standards, and the entity does not receive deposits or loans from members of the general public, and the securities of the entity are not issued to members of the general public (SAICA 2002:4).

Non-reporting entity

No public share ownership, public debt and other forms of public interest.

Owner-managed entities

Entities where there is no distinction between the owners and the managers of the entity, and where there is a limited number of members, all involved in the day-to-day operations of the entity.

Small or closely held entities

Entities with no users of the financial statements that are not in a position to demand additional financial information.

ABBREVIATIONS

AAA	The American Accounting Association
AARF	The Australian Accounting Research Foundation
AASB	The Australian Accounting Standards Board
AASB 1025	Approved Accounting Standard
AcSB	The Canadian Accounting Standards Board
AICPA	The American Institute of Certified Public Accountants
APB	Accounting Practices Board
APC	Accounting Practices Committee
ASB	Accounting Standards Board
ASSC	The Accounting Standards Steering Committee
CASE	Committee on Accounting for Smaller Entities
CFA	Commercial and Financial Accountants
CICA	The Canadian Institute of Chartered Accountants
CPA	Certified Public Accountant
DP	Discussion Paper
ED	Exposure Draft
FASB	Financial Accounting Standards Board
FRA	Financial Reporting Act
FRS	Financial Reporting Standard
FRSB	Financial Reporting Standards Board
FRSSE	Financial Reporting Standard for Smaller Entities
GAAP	Generally Accepted Accounting Practice
IAS	International Accounting Standards
IASB	International Accounting Standards Board
IASC	International Accounting Standards Committee
IASSME	International Accounting Standards for Small and Medium-sized Enterprises
ICAEW	The Institute of Chartered Accountants in England and Wales

ICAS	The Institute of Chartered Accountants of Scotland
IFRS	International Financial Reporting Standards
ISAR	International Standards of Accounting and Reporting
LPFS	Limited Purpose Financial Statements
LPFRS	Limited Purpose Financial Reporting Standards
OCBOA	Other Comprehensive Basis Of Accounting
SA	South Africa
SAC	Standing Advisory Committee on Company Law
SAC	Standards Advisory Council
SAC 1	Statement of Accounting Concepts 1
SAICA	South African Institute of Chartered Accountants
SARS	South African Revenue Services
SBE	Small Business Enterprises
SEFRC	Small Enterprises Financial Reporting Committee
SME's	Small and Medium-sized Enterprises
SSAP	Statement of Standard Accounting Practice
UITF	Urgent Issues Task Force
UK	United Kingdom
USA	United States of America

ABSTRACT

The Close Corporations Act requires that the annual financial statements of close corporations must, in conformity with generally accepted accounting practice appropriate to the business of the corporation, fairly present the state of affairs of the corporation at the end of the financial year concerned, and the results of its operations for that year.

According to generally accepted accounting practice, the objective of financial statements is to provide useful information about the enterprise to the primary user groups of the financial statements, independent of the size of the entity. The primary user groups of the financial statements of close corporations are the members, SARS and bankers.

The recognition, measurement and disclosure requirements contained in the Statements of GAAP do not give rise to cost-effective and useful information being provided to the users of financial statements of close corporations and other small entities, because these users do not require the extensive information provided in general purpose financial statements. Consequently, an accounting standard is required to differentiate between general and limited purpose financial statements.

In South Africa, the Limited Purpose Financial Reporting Standards (LPFRS) were developed. The modifications stipulated in this LPFRS mainly relate to the disclosure requirements that were reduced, with only a few alternatives allowed to the recognition and measurement criteria relating to deferred tax and financial instruments. These developments may not be sufficient enough for the purposes of close corporations.

Accordingly, the study recommends that a formal, separate set of simplified differential reporting standards be developed for the purpose of close corporations. To be acceptable, the reporting method should meet most of the information needs of the users of the financial statements of close corporations and other small entities, and simultaneously provide cost-effective information that is a fair presentation of the results, taking into consideration the additional costs that may result from adopting differential reporting standards.

Key words

Generally accepted accounting practice; cost-effective and useful information; limited purpose financial statements; differential reporting; fair presentation

OPSOMMING

Die Wet op Beslote Korporasies vereis dat die finansiële state van beslote korporasies in ooreenstemming met algemene aanvaarde rekeningkundige praktyk, geskik vir die besigheid van die korporasie, 'n getroue weergawe moet wees van die stand van sake van die korporasie aan die einde van die finansiële jaar ter sprake en die resultate van die besigheid vir daardie jaar.

Die doel van finansiële state volgens algemene aanvaarde rekeningkundige praktyk, is om bruikbare inligting oor die entiteit aan die primêre gebruikers van die finansiële state te verskaf, ongeag die grootte van die entiteit. Die primêre gebuikers van die finansiële state van beslote korporasies is die lede, SARS en banke.

Die erkenning, meting- en openbaarmakingsvereistes soos vervat in die Standpunte van Algemene Aanvaarde Rekeningkunde Praktyk (AARP), verskaf nie koste-effektiewe en bruikbare inligting aan die gebruikers van die finansiële state van beslote korporasies en ander klein entiteite nie, aangesien die gebruikers nie die uitgebreide inligting soos verskaf deur algemene doel finasiële state, vereis nie. Gevolglik word 'n rekeningkundige standaard vereis wat onderskei tussen algemene en beperkte doel finanisiële state.

In Suid-Afrika is die Beperkte Doel Finansiële Verslagdoening Standaarde ontwikkel. Die modifikasies uiteengesit in hierdie Beperkte Doel Finansiële Verslagdoening Standaarde hou hoofsaaklik verband met die openbaarmakingsvereistes wat verminder is, met slegs beperkte alternatiewe toegelaat rakende die erkenning- en metingsvereistes, wat verband hou met uitgestelde belasting en finansiële instrumente. Hierdie ontwikkelinge mag dalk nie voldoende wees vir die doel van beslote korporasies nie.

Gevolglik beveel hierdie studie aan dat 'n formele, afsonderlike stel vereenvoudigde standaarde ontwikkel word vir die doel van beslote korporasies. Om aanvaarbaar te wees moet die verslagdoeningsmetode aan die meeste van die inligtings behoeftes van die

gebruikers van die finansiële state van beslote korporasies en ander klein entiteite voldoen en terselfdertyd koste-effektiewe inligting verskaf wat 'n redelike weergawe is van die resultate van die entiteit, met inagneming van die addisionele koste wat mag voortspruit uit die toepassing van diverensiële verslagdoening standaarde.

Sleutelwoorde

Algemene aanvaarde rekeningkundige beleid; koste-effektiewe en bruikbare inligting; beperkte doel finansiële state; diverensiële verslagdoening; getroue weergawe

CHAPTER 1

INTRODUCTION

1.1. Opening remarks

Close corporations as an alternative corporate form for business ventures in South Africa play an important role in the current economy as a great deal of entrepreneurs manage their business and financial affairs by means of close corporations. The financial statements of close corporations also play an important role in the management of the business affairs of the mentioned close corporations, as they are used to calculate tax, to raise loan finance and as basis for financial decisions regarding the business of the close corporations. Accordingly, the financial reporting requirements for the financial statements of close corporations are regarded as an important and relevant topic in the current economic environment.

1.2. Background

The accounting statements of Generally Accepted Accounting Practice (GAAP) in South Africa (SA) have been developed over a number of years into a voluminous and complex series of statements, guides, opinions and interpretations. It has evolved in various economic and business environments as a means to record and fairly present the transactions and events common to these environments (Cilliers, Benade, Henning, Du Plessis, Delport, De Koker, Pretorius 2000:658).

The developments are the result of meeting the needs of the financial market and accounting for new types of complex financial transactions, as well as emanating from the policy of the Accounting Practices Board (APB) to harmonise South African Statements of

GAAP with International Financial Reporting Standards (IFRS) (Prinsloo 2000:1). Further refinements in accounting standards also resulted from the quest for information which is both legally acceptable and technically sound and reliable. As a result, financial reports, as the final product of the accounting process, tend to be too technical and very complex. In addition, the volume of some annual reports has increased substantially in order to satisfy the information needs of the professional user and to comply with disclosure requirements (Joubert 1993:4).

This increase in volume and complexity led to the question as to whether or not companies with few external users should be required to apply accounting standards primarily intended to meet the needs of users of the financial statements of listed companies (Prinsloo 2000:1). In response to this question, leading countries such as the United Kingdom (UK), Australia, Canada and New Zealand proceeded to apply differential reporting standards to small/medium enterprises, defined by size or some other characteristic (Heymans 2000:31).

Differential reporting relates to the imposition of different statutory and professional reporting requirements for different categories of reporting entities. The implication is that certain entities should be exempt from applying statutory and professional reporting requirements. This means that categories of entities are granted legal and professional approval to provide relatively limited disclosure to external users. Examples of different reporting categories are large versus small entities, public as opposed to private companies or some combination of legal structure and size (Holmes, Kent & Downey 1991:126).

Differential reporting was also introduced in SA with the release of Discussion Paper (DP) 16, "Limited Purpose Financial Statements (LPFS)" by the South African Institute of Chartered Accountants (SAICA), in May 2000. The purpose of DP 16 was to determine whether respondents supported differential reporting and the proposed reduced disclosure requirements. Generally, the responses to the recommendations contained in DP 16 were favourable and all responses welcomed a move towards differential reporting (compare Cleminson & Rabin 2002:336).

The next step taken in the move towards differential reporting was the publication of "The Proposal of SAICA with regards to Legal Backing for and the Monitoring of Compliance with Accounting Standards", in April 2001. In this document it was further acknowledged that it is neither reasonable nor practical to require small companies to comply with current accounting standards. It was proposed by SAICA that the Companies Act, 1973 (Act No. 61 of 1973), be amended to provide for small companies to prepare financial statements in conformity with Limited Purpose Financial Reporting Standards (LPFRS) (Koppeschaar 2002:3).

Further developments include the proposed "Financial Reporting Act", which is to be issued at the same time as the above-mentioned proposed Companies Act Amendments. The Financial Reporting Act provided for the establishment of a Financial Reporting Council responsible for laying down LPFRS. It also provided for the Financial Reporting Standards Council to appoint a subcommittee to develop the standards for approval by the Council (Koppeschaar 2002:3).

As part of the development process, the above-mentioned subcommittee, the Limited Purpose Financial Reporting Committee of SAICA, prepared Exposure Draft 163, "Framework for the preparation and presentation of limited purpose financial statements", published in June 2003, providing guidance for the development of LPFRS (SAICA 2003:13). In this framework it is encouraged that entities that are not required to prepare general purpose financial statements, defined by AC101 as those statements intended to meet the needs of users that are not in a position to demand reports tailored to meet their specific information needs, should prepare financial statements in conformity with LPFRS (SAICA 2003:16).

As a result of the above-mentioned developments, the question arises as to whether or not close corporations fall under the scope of this framework, keeping in mind that it is no longer recommended by SAICA that close corporations comply with the Statements of GAAP (SAICA 2001:8). This reconsideration was recorded in SAICA's "Guide on Close Corporations", published in December 2001, after it was recommended in DP16 that the Statements of GAAP should not be applicable to close corporations, partnerships, sole traders and trusts, as this is seen as an unnecessary burden on enterprises that wish to avoid the formalities of a company (SAICA 2000:9).

At present, the Close Corporations Act requires that the annual financial statements of close corporations must, in conformity with generally accepted accounting practice appropriate to the business of the corporation, fairly present the state of affairs of the corporation as at the end of the financial year concerned, and the results of its operations for that year (Close Corporations Act, No. 69 of 1984, sect. 58(2b)). This requirement is further explained in the above-mentioned "Guide on Close Corporations".

In this "Guide on Close Corporations" it is elucidated that in determining what is generally accepted accounting practice appropriate to the business of the corporation, the preparer of the annual financial statements should have regard to the needs of the members of the close corporation. In deciding what is "appropriate to the business", consideration should be given to the trading and operating activities of the corporation and the generally accepted accounting practices of the environment in which the corporation operates (Cilliers, Benade *et al.* 2000:657). It is further accentuated in the Guide on Close Corporations that fair presentation is to be the overriding requirement in the preparation of the annual financial statements of a corporation (SAICA 2001:22).

The above-mentioned requirements and the characteristics of close corporations, for example owner-management, result in the conclusion that general purpose financial statements are not a requirement for close corporations. Therefore, close corporations are only encouraged to prepare financial statements in conformity with LPFRS. However, participants of the Consultative Forum for "Legal backing for and monitoring of compliance with accounting standards" concluded that the legislation governing close corporations needs to be reviewed and the position of close corporations with regard to complying with financial reporting standards needs to be clarified (SAICA 2002:Webpage). It was further recommended that a clearly defined reporting framework for close corporations be developed (SAICA 2000:9).

This current uncertainty regarding the financial reporting requirements of close corporations forms the basis of the problem statement of the study. The problem statement is analysed in the following section.

1.3. Problem Statement

From the background given it is clear that at present there is no clearly defined reporting framework for close corporations implementing the financial reporting requirements worded in the Close Corporation Act, No. 69 of 1984, sect. 58(2b). Accordingly, compliance with these requirements may not always be achieved in the financial statements of close corporations.

According to Hepp & McRae (1982:56), this problem will not be fully and finally solved until consideration has been given to whether and to what extent the needs of users of financial statements of small or closely held businesses differ significantly from the needs of users of financial statements of large, public companies and whether the costs of implementing some standards exceed the benefits derived from the information they produce. The question is not merely whether or not the application of existing standards should be relaxed, but whether alternative standards of recognition, measurement, and/or disclosure would better achieve the objective of financial reporting for owner-managed entities (Wilson 1995:93).

Since the objective of financial statements is defined as to provide useful information to the users of the financial statements, it is the opinion of Wilson (1995:93) that the needs of users of financial statements should determine the objectives of financial reporting, leading ultimately to the form and content of financial statements. Furthermore, if the users do not regard the financial statements as useful and reliable, reporting has no value (Stegman 1994:50). For this reason McAleese (2001:18) concluded that the information needs of the users should be prioritised in designing a new format of financial statements, involving extensive consultation with both the users of financial statements of small entities and the small and medium-sized accountancy practices which deal with these entities on a day-to-day basis. Accordingly, the users of financial statements of small entities need to be adequately researched in order to develop appropriate reporting practices (Wilson 1995:93).

With regard to this point, a working party in the UK concluded in their Consultative Document, "Exemptions from Standards on Grounds of Size or Public Interest", published in November 1994, that while there is a body of research on the needs of the users of the financial statements of large companies, much less is known about who uses the financial statements of small entities and the information they require (Dugdale 1998:50). It is therefore concluded by Dugdale, Hussey & Jarvis (1997:32) that there is a profound lack of knowledge as to who uses the financial statements of small and medium-sized entities and for which purpose the information is used.

The problem can be worded as follows:
What are the information needs of the users of the financial statements of close corporations and how can these needs be satisfied?

Another problem arose as a result of attempts to provide an answer to the above-mentioned problem statement. This problem revolves around the overriding requirement of fair presentation in the financial statements of close corporations and is questioned by Walton (1998:2): "If the financial statements are supposed to give a true and fair view, how can one say that some entities have a different kind of true and fair view than others?" This is further explained by Coppin (1996:12): "If different standards apply to smaller entities, it could result in the situation that disclosures provided by larger enterprises may not be regarded as fair presentation, but exactly the same presentation will be considered fair presentation in smaller enterprises." This would mean that fair presentation is viewed not against a standard that is common to all enterprises, but against some arbitrary criterion which distinguishes between the sizes of enterprises.

The counter-argument raised by Walton (1998:2) is that small and large enterprises are very different kinds of entities and that the differences between them should be reflected in their financial statements. Differential reporting simply reflects the economic reality in regulation. This protects the small enterprise from excessive and burdensome rules, while allowing the regulator to focus on the real problems of multinational reporting.

Both these counter-arguments are underpinned by valid reasoning and therefore the problem statement can be extended to read as follows:
How can the information needs of the users of the financial statements of close corporations be reconciled with the overriding requirement of fair presentation?

1.4. Formulation of hypothesis

The information needs of the users of financial statements of close corporations will not be met by financial statements prepared according to the Statements of GAAP. The recognition, measurement and disclosure requirements contained in the Statements of GAAP will not give rise to cost-effective and useful information being provided to the users of financial statements of close corporations. Managerial, cash flow and tax-based information would be more useful.

1.5. Objectives of the study

The first objective to be achieved by the study can be expressed as follows:

- To clarify the meaning of an annual report by investigating the broad aspects of financial reporting;
- To identify the users of the financial statements of close corporations; and
- To identify the broad information needs of users.

The above-mentioned information could be of use in the development of a financial reporting framework for close corporations and possibly also for all the other small entities.

The second objective to be achieved is to examine the meaning of fair presentation as overriding requirement for the financial statements of close corporations. This information is required in order to reconcile the information needs of the users of the financial statements of close corporations with the overriding requirement of fair presentation.

1.6. Scope

The study will concentrate on the information needs of the main user groups of the financial statements of close corporations. Although some private companies can also be classified as owner-managed enterprises and small entities, the focus will be on close corporations only.

1.7. Research Methodology

A literature study of the development of financial reporting for small entities forms the basis of the study. A questionnaire relating to the financial statements of close corporations in the Free State was developed and distributed to the following parties:

- Members of close corporations;
- Commercial and Financial Accountants (CFAs) as preparers of financial statements;
- Bankers who provide overdraft facilities and loans; and
- The South African Revenue Services (SARS).

The results of the empirical test are discussed throughout the study, and analysed in detail in chapter 5.

1.8. Contents of the study

The contents of the study are set out in a logical sequence in the following six chapters:

Chapter one contains the background, problem statement and the objectives of the study. It also gives an exposition of the scope of the research and methodology used in conducting that research.

In chapter two the broad aspects of financial reporting are examined. Firstly, the objective of financial statements and the needs of their users are discussed in general and then compared to those of small entities, with the emphasis on close corporations. Furthermore, the concept of fair presentation as overriding requirement for the financial statements as contained in the Close Corporations Act, is analysed, and the cost vs. benefit constraint as prescribed in the Statements of GAAP is put into perspective.

In chapter three the international development process of differential financial reporting for small entities is discussed. The difficulties experienced in the developing process are also explained, highlighting different views on the necessity of these developments and presenting research evidence already gathered on these difficulties. The current differential reporting models are also discussed.

In chapter four the concept of differential reporting as used in different countries is discussed in detail. Although the various solutions implemented by these countries differ significantly, they have all formally recognised that there is a pressing problem for small enterprises and have thus agreed to introduce a form of differential reporting for these enterprises. The different solutions proposed are compared and discussed by referring to the countries mentioned, namely:

- The United Kingdom
- New Zealand
- Australia
- Canada
- The United States
- South Africa
- The International Accounting Standards Board

In chapter five a description of the empirical research methodology used is given. The limitations of the research conducted are listed and the results of the study are discussed and summarized.

Chapter six contains a summary of the study with a discussion of the overall conclusion reached. Recommendations and proposals for further research proceeding from the study are given.

CHAPTER 2

FINANCIAL REPORTING IN GENERAL

2.1 Introduction

The first objective of the study, as stated previously, is to clarify the meaning of an annual report by investigating the broad aspects of financial reporting. This forms the basis for the main objective of this chapter, namely to investigate the applicability of the broad aspects of financial reporting to close corporations and other small entities. This objective is achieved by analysing the fundamental aspects and requirements of financial reporting, including the objective of financial statements, their users and the requirements of fair presentation, substance over form and cost vs. benefits.

The chapter starts with a discussion of the overall nature of accounting, in order to assist the reader in understanding the concept of financial reporting and the purpose of all the accompanying aspects and requirements contained in the Statements of GAAP. These aspects and requirements, as listed above, are firstly defined in general and then made applicable to close corporations and other small entities.

2.2 The nature of accounting

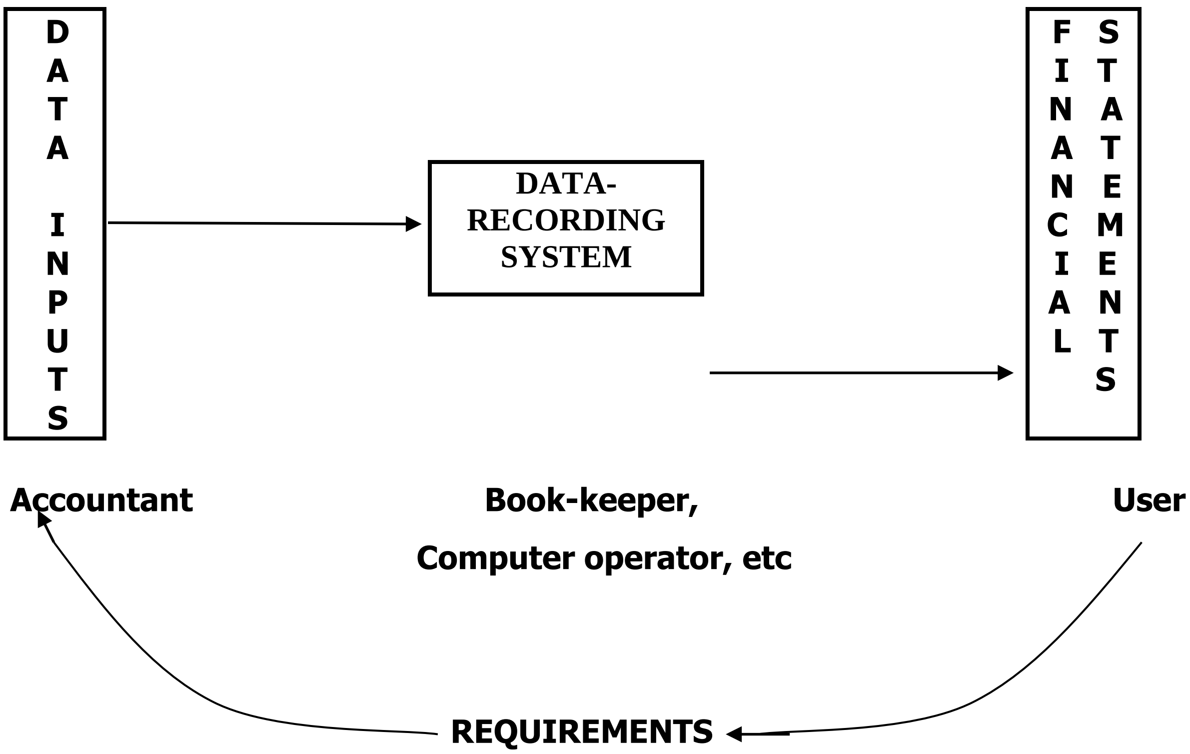
According to Stegman (1994:50) accounting can be regarded as the language of the business world. Every business, whatever its size and nature, must keep proper accounting records and prepare reliable annual financial statements reporting on its results and financial position at the end of each financial year of operation (Symington 1986:9).

In its most basic form accounting is necessary to "keep the score" so that the entrepreneur will know what is happening in the business, how much has been sold, what the costs are, what activities are profitable, whether selling prices leave a suitable margin against cost, etc. Accounting is also critical in managing relationships with the outside world, for example it records to which suppliers money is owed and from which customers money is due. It also enables the entrepreneur to represent the business to outside interests, particularly potential lenders and also the tax authorities (United Nations Trade and Development Board 2000:6). Furthermore, owners of businesses may wish to compare their success with that of other businesses, and they may wish to use financial information to make decisions about the future (Nobes 1992:1).

As a result of the above-mentioned financial information needs, an accounting process was developed. The figure below illustrates this accounting process.

Figure 1: The accounting system

(Alexander & Britton 1993:6)



The accounting process can be explained as follows:

- The central stage in the accounting process is the data-recording system. Whatever its precise form, it is a system for handling and recording data (Alexander & Britton 1993:5).
- The end product of the recording system is the financial statements. This is the information the user receives (Alexander & Britton 1993:5) and assists him in achieving the main purpose of accounting communication, namely to affect the behaviour of the user/reader through financial messages (Gouws 1995:20). However, it should be kept in mind that communication is only accomplished if the receiver of the information can use the information and if the behaviour of the receiver is influenced by it (Stegman 1994:50). This means that the recipient must understand the message received (Murphy 1997:Webpage). It can therefore be concluded that the final stage in the accounting process should be controlled by the reader or user of financial statements (Alexander & Britton 1993:5).
- The first stage is when the accountant enters the figures on the data recording system in order to produce the end product required by the users (Alexander & Britton 1993:5). The accountant, who is the preparer of financial statements or conveyor of messages, is initially responsible for successful communication. The accountant should therefore be aware of the purpose of the message being sent. The objective when the accountant communicates is with the expectation that something will happen. The accountant must understand what the users want to do with the information and therefore ensure that the messages are clearly communicated, received and understood (Gouws 1995:19).

It can be concluded from this explanation of the accounting system that the goal of accounting should be viewed as communication, namely the supply of information to all parties with an interest in the operations of a specific enterprise. The information is communicated to interested parties by, *inter alia*, the financial statements that are prepared periodically (Vorster, Koen, Koornhof, Oberholster, Koppeschaar 2003:1). This conclusion is confirmed by Saenger (1994:6), who stated that in broad outline, financial reporting could be described as a method according to which decision-useful information is communicated by organisations to interested parties. Basson (2001:8) also stated that financial statements form an indispensable communication instrument in the modern commercial society.

Another conclusion reached by Swinson (2002:85) on the accounting system is that one of the weaknesses of the accounting communication process is that the financial statements are no better (and no worse) than the people who prepare them. This emphasizes the importance of the preparation method used in the accounting communication process.

The importance of the preparation method is further accentuated by the opinion of some users that accounting is failing its main purpose, i.e. to communicate to the users of the financial statements. As a result, the usefulness of financial statements of close corporations and other small companies is being questioned. This issue is investigated further in the next section with an analysis of the overall objective of financial statements.

2.3 Objective of financial statements

In the previous section, it was concluded that the main purpose of accounting is to communicate to the users of the financial statements. This forms the basis for the overall objective of financial statements, which is defined in the AC 000 Framework for the Preparation and Presentation of Financial Statements as the provision of information about the financial position, performance and changes in financial position of an enterprise that is useful to a wide range of users in making economic decisions (Everingham, Kleynhans & Posthumus 2003:7).

Paragraph 10 of the proposed Preface to International Financial Reporting Standards (IFRS) and the conceptual frameworks of national standard setters sends a similar message as the above-mentioned definition (IASB 2002:2). Accordingly, it is concluded by Qua-Enoo (2002:120) that most professional bodies agree that the financial reporting must be relevant to the users. It must be useful to them in one way or another, keeping in mind that each category of users would be looking for particular information that may be distinct from the information required by another group of users.

The above-mentioned view is supported by Olsson (1981:542) with the statement that it is generally accepted that the purpose of an annual report is to provide information for use as a basis for action and that such reports should be designed to enable the reader to elicit answers to questions that will affect decisions or increase his knowledge. Accordingly, an annual report will be perfect or not perfect, adequate or not adequate, depending upon the questions that the report is designed to answer and on the communicating skills employed in its preparation. Furthermore, the particular characteristics and business environment of a company will suggest the type of questions that need to be answered. Obviously the questions appropriate to a financial company will differ from those appropriate to a manufacturing company or a mining company or a land development company, etc. The information required to answer the questions raised may also be presented in numerous ways (Olsson 1981:545).

Should one use the above objective as a point of departure for financial reporting, the emphasis of the reporting effort moves away from the mere supplying of financial figures to a concerted effort to communicate with the target market. This requires that the emphasis of reporting be placed on both the informational content of the reports, as well as their proper presentation, in order to reach the target market effectively (Joubert 1993:4). This is further explained by Luke (2000:23), who stated that financial statements should essentially not represent a list of numbers, but should rather represent the business events that have taken place, resulting in a set of financial statements which can become a tool by means of which the user can judge the enterprise and the management thereof.

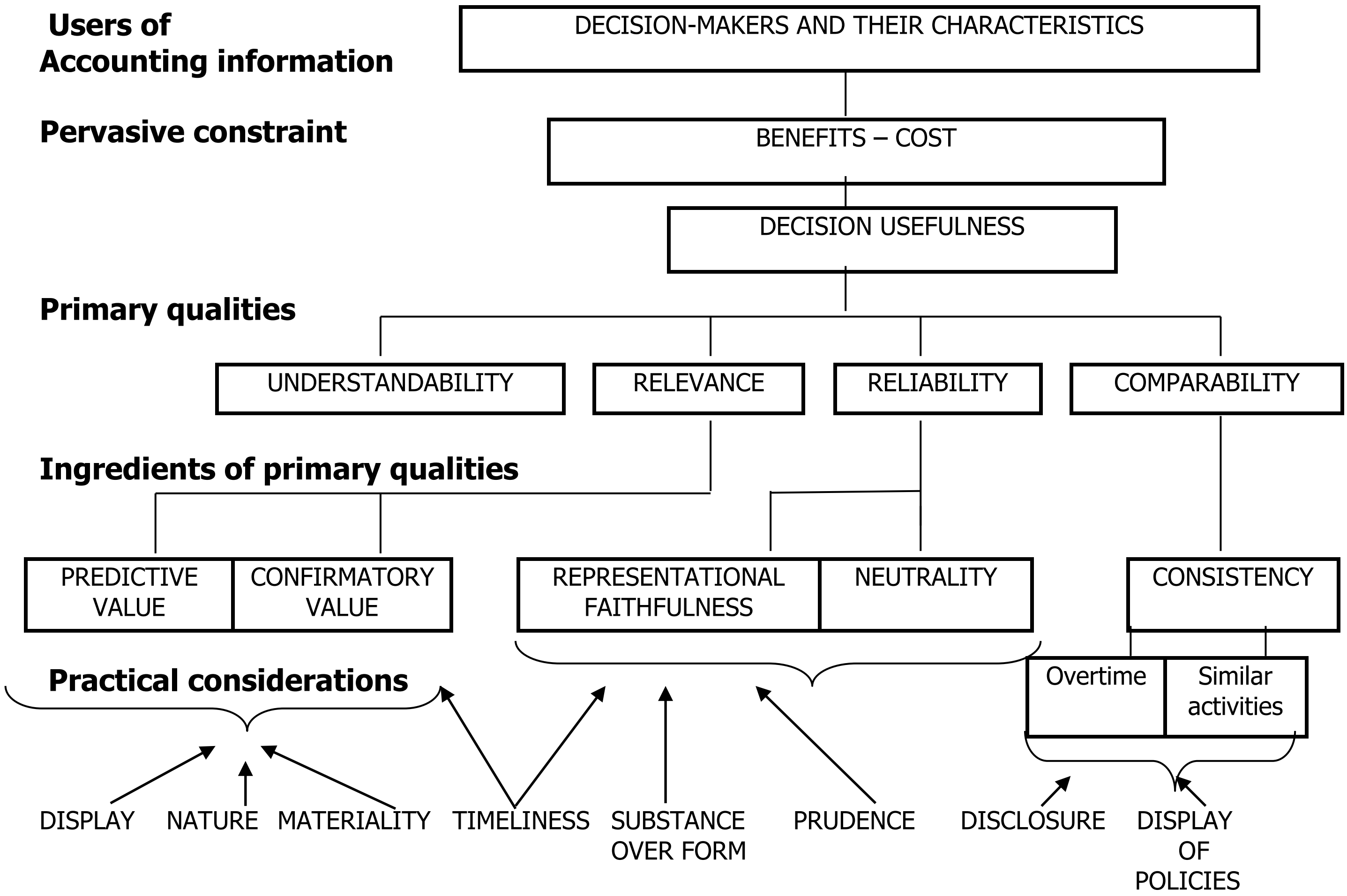
Saenger (1994:6) further concluded that several professionals and professional accounting organisations, including the accounting institutions in several leading countries (also SA), agree that usefulness for economic decision-making should be the most important criterion for the disclosure of financial information. This conclusion gives rise to the question: when can information be regarded as useful? The Corporate Report published by the ASSC suggested the following seven characteristics of useful information (Alexander & Britton 1993:15):

- Relevance – information has the quality of relevance when it influences the economic decisions of users by helping them evaluate past, present or future events or confirming or correcting there past evaluations;
- Understandability - information must be understandable to users, who in turn are assumed to be reasonably sophisticated with respect to business and accounting. Understandability will further differ according to the user group;
- Reliability – to be reliable, information must be free of material error and bias, and users must be able to depend on it being represented faithfully. Furthermore, to be reliable, information must embody the concepts of substance over form, neutrality, prudence and completeness;
- Completeness – the information should be complete to ensure that users are fully informed;
- Objectivity – the information should be objective and not subjective in order to influence the users in any way;
- Timeliness – the trade-off here is that, generally, the more quickly information is available, the less reliable it is and *vice versa*; and
- Comparability – comparability requires consistency of treatment of similar transactions over a period of time or within enterprises.

In the AC 000 it is also stated that the qualitative characteristics are those attributes that make the information provided in the financial statements useful to users. The four principle qualitative characteristics as identified in AC 000 are understandability, relevance, reliability and comparability (SAICA 2004:par24). The hierarchy of accounting qualities as presented by AC 000 is illustrated as follows:

Figure 2: Hierarchy of accounting qualities as presented in AC 000

(Everingham, Kleynhans & Posthumus 2003:8)



Relevance, reliability and comparability are apparently viewed as the key attributes, with other characteristics viewed as sub-attributes contributing to the fulfillment of the key properties. However, information can only be useful if it can be understood, even if it may be reliable in and relevant to the decision-making context (Smith 1996:11). Accordingly, the conclusion is reached by the IASB (2002:1) that any response to the perceived needs of small entities must be consistent with the objective of meeting the needs of the users.

The opinion of the CFAs and members of close corporations on what they see as the objective of the financial statements of close corporations was tested in the empirical research study. Their responses can be summarised as follows:

According to the members of close corporations the objectives are:

- To ascertain your profit or loss;
- To report to the relevant interested parties;
- To give record of the operations of the year;
- To provide information for managing and tax purposes;
- To ascertain growth over a period of time;
- To calculate leverage;
- For government regulation; and
- To keep the bank and SARS happy.

According to the CFAs the objectives are:

- To give information in an easy format, that is plain, understandable and short, but supported by a financially sound basis;
- To be a tool to be used by business owners – therefore the statements should become more in line with actual business activities and market trends, resulting in a need for tax reform in order to meet with these compliances;
- To give a true reflection of the profits, assets and liabilities of the company; and
- To give an accurate and fair presentation of the operations of the close corporation concerned.

However, according to some CFAs, most close corporations are too small to warrant or afford correct workings. The paying of tax and VAT tend to be the main considerations of members.

The above-mentioned results show that individuals have different opinions on what the objectives of financial statements should be. In addition, the reality is that there are major differences between entities: differences that derive from size, from ownership and from industry at the very least (Walton 1992:43). These differences also result in the conclusion reached by Ivancevich *et al.* (1997:23), namely that the objectives for financial reporting of small and large businesses, especially large public companies, may differ considerably.

The reason for the difference in objectives lies in the fact that the owners and management are presumed to be the same group of persons in a close corporation and most small companies. Accordingly, the annual financial statements of a small entity should, as a primary objective, fully meet the needs of members/directors, both as owners and as concerned management (SAICA 2001:20). Furthermore, some decisions can affect the accountability of the members/directors and for this purpose the financial statements are a requirement, with the objective of being management directed, timely and aimed at providing the correct information (Uys 1987:55). Everingham & Kana (2004:248) conclude that the prime objective of the financial statements of close corporations is to provide timely information that fairly presents the affairs of the close corporation and allows effective management thereof.

It is seen from the above that even though the users of the financial statements of small and large entities may differ, the main objective of the financial statements still remains to provide useful information to those users. To summarize, Pietersen (1992:52) stated that the primary objective of financial reporting, for both close corporations/small companies and large public companies, is to provide the primary user groups with useful information to assist them with economic and investment decisions. Accordingly, the users of the financial statements should determine the information to be presented in the financial statements.

The difference between large and small entities lies in the users of their financial statements, and therefore the users of the financial statements of close corporations should be determined. This is done in the next section in which the users of financial statements are discussed, firstly in general and then specifically for close corporations.

2.4 Users of financial statements

In paragraph 2.2 where the nature of accounting was discussed, it was concluded that the ongoing nature of accounting communication emphasises the fact that the real power of accounting is manifested at the hands of the user (Gouws 1995:19). It was further determined from the discussion on the objectives of financial statements that the principal objective of financial reporting is to provide information useful to a wide range of users for making economic decisions (Ekholm & Troberg 1998:117). For this reason Pietersen (1992:54) stated that users fill an important position in the presentation of financial statements. It is even recognised by Burton, as quoted by Burton & Hillison (1979:18), that the information needs of users are of paramount importance in financial reporting.

The above-mentioned statement is also expressed in the Canadian Financial Statement Concepts, Section 1000, namely that the contents of financial statements must be driven by the needs of users of financial statements (Mersereau 2002:32). Accordingly, as previously stated, the users of financial statements should determine the information to be presented in the financial statements. It should, however, be kept in mind that different users have different accounting requirements (United Nations Trade and Development Board 2000:12). This opinion is also expressed by Gouws (1995:19), who stated that who one is, determines what one needs from financial statements. It is thus clear that different users groups have different information needs.

The differences in the information needs of different users give rise to the question: how will the different accounting requirements be satisfied? In the opinion of Alexander & Britton (1993:6) there are three fundamental issues to be considered in endeavouring to satisfy the information needs of the users of financial statements, namely:

- Who are the users of financial statements?
- For which purpose does each particular type of user require the information? and
- How can the user be provided with the information which is best suited to his needs?

Furthermore, in the opinion of Gouws (1995:19) input from all external users, as well as information on their ability, understanding and preferences, must be considered.

The above-mentioned fundamental issues were also made applicable to small businesses by Burton & Hillison (1979:24) by supplying the following questions:

- Who are the users of Small Business financials?
- Are they different from users of other financials? and
- How do their needs for information differ?

It is clear from the above-mentioned that in order to identify the users of the financial statements of close corporations, the following questions need to be answered:

- Who are the users of the financial statements of close corporations?
- Are they different from the users of public companies? and
- How do their needs for information differ?

These questions are discussed in the following sections.

2.4.1 Who are the users of financial statements?

AC 000 lists seven categories of users, explaining in each case why information is needed (Everingham, Kleynhans & Posthumus 2003:6). The categories listed in the AC 000 are: investors, employees, lenders, suppliers and other trade creditors, customers, governments and their agencies, and the public (SAICA 2004:par9).

It is significant that AC 000 does not specifically identify management as a specific user group. This is because management forms part of the employee group, but has access to information which other groups are excluded from (Everingham, Kleynhans & Posthumus 2003:7). This distinction is important, because in large entities there is often a split between the ownership and the management of the enterprise, which requires additional disclosure to ensure that the owners get a full picture of the stewardship of their assets.

In contrast to these large entities, the owner and manager in smaller enterprises are often the same person, which results in owners being less dependent on formal disclosures in the financial statements (Coppin 1996:11).

SAICA (2000:3) further expanded on the categorisation of the users in DP 16 by dividing the users of financial statements broadly into two groups, namely:

- Those who have a right to demand and receive additional financial information in order to meet their needs for decision-making purposes; and
- Those who are not in a position to demand additional financial information.

It is generally believed that the users of the financial statements of close corporations and other small entities mostly fall into the first category because they have a right to demand and receive additional financial information in order to meet their needs for decision-making purposes.

Cleminson & Rabin (2002:333) made a further distinction between the users of financial statements of large and small entities. According to them, in contrast to large entities, the users of the financial statements of small business entities (SBEs) are few in number and their needs are more specific, with the main external users of the financial statements, to a large extent, being banks and tax authorities (United Nations Trade and Development Board 2001:9).

This view is also expressed by Koppeschaar (2002:2), who stated that small companies are often run by a small number of shareholders who, along with tax authorities and financial institutions, are the main users of financial statements. Furthermore, shareholders may all be family members and the entity may have only a few employees who take little interest in, or have little access to, its financial statements. This limited interest in and access to the financial statements of small entities could also be true of the public at large (IASB 2002:3).

Another important distinction between large public companies and small entities lies in the distribution of the financial statements. The financial statements of a public company are widely circulated and available to an unlimited number and wide variety of users who benefit from access to a broad range of detailed financial information. On the other hand, the circulation of financial statements of non-public enterprises beyond management is controlled by the board of directors or other governing body. It is generally restricted to owners that are not involved in the management or governance of the enterprise and to lending institutions. The latter may also have access to additional information, given their economic leverage, while the former, in certain circumstances, may have agreed access to internal information (Mersereau 2002:32).

This limited circulation of financial statements of non-public enterprises, is particularly relevant in SA where the financial statements of close corporations and private companies are not public documents. This means that besides revenue authorities and banks, no one else will generally see their financial statements (Coppin 1996:11).

Furthermore, as stated previously, the nature of close corporations is such that there is no need for financial statements to report in any way to shareholders on the performance or stewardship of the directors. The reason for this being that a close corporation does not have shareholders or directors but only members, all of whom are entitled to, subject to an association agreement, take part in the management of the corporation. Also, having regard for the intended closely held membership, it is likely that there will be very limited distribution of the financial statements. It is further likely that there will be very little use for or reliance on the financial statements by persons other than the members themselves, because of the very limited value attached to the report of the accounting officer reporting on the financial statements of a corporation, as no audit is required (Symington 1986:70). Everingham & Hopkins (1993:3) thus concluded that the financial statements of close corporations are prepared primarily for distribution to its members.

The CFAs and members of close corporations were requested in the empirical research study to name the users to whom they send copies of the financial statements of close corporations. The following users were identified in most cases:

- Banks/financial institutions;
- Other members;
- SARS.

To a much smaller extent, the following users were also identified:

- The credit bureau;
- Creditors/suppliers; and
- Investors.

It can therefore be concluded that the members are not the only users of the financial statements of close corporations. Even so, the financial statements are distributed to a limited number of users, in comparison to large public companies.

The above-mentioned results identify the users of the financial statements of close corporations. In order to identify how their needs for information differ from the needs of the users of the financial statements of public companies, the purpose for which users require information is discussed in the next section.

2.4.2 The purpose for which users require information

The question raised by the IASB (2002:2) on the purpose for which users require information is if the information needs of the of the users of the financial statements of small entities are different compared to the information needs of the users of the financial statements of public entities. If so, do the first-mentioned users require less information (the usual assumption) or different and perhaps additional information about the entity concerned? These questions are analysed in the following paragraphs.

According to Olsson (1981:544) many people base decisions on their relationship to, and knowledge about, corporate business entities. Martin (2000:48) also stated that the information needs of users are determined by factors such as the degree to which investors, lenders and others rely on financial statements in making decisions, and the type of investment and lending decisions that users of financial statements are making. This is one of the reasons why Blumberg (1996:7) stated that possibly the greatest difficulty in meeting the information needs of users is that their needs vary according to the particular relationship of the user with the reporting enterprise.

It is further the opinion of the IASB (2002:2) that the interests of users differ when the attention turns to a smaller entity. This opinion is supported by Cleminson & Rabin (2002:335) who expressed the opinion that because the classes of users of financial statements of small and large companies vary in nature and number, their respective information needs cannot be viewed as being similar. Furthermore, according to John & Healeas (2000:18), informal lines of communication exist between the owner-managers of small entities and their user groups. Therefore Lavigne (1999:49) concluded that small businesses and their stakeholders really do have unique reporting needs.

It is clear from the above citations that the information needs of the users of small entities are different compared to the information needs of the users of public entities. These differences in information needs are analysed in further detail for the main user groups of the financial statements of close corporations and other small entities as identified in paragraph 2.4.1, namely the owners, tax authorities, banks and creditors.

2.4.2.1 Owners

In the opinion of Jackson (1997:75), shareholders of owner-managed companies do not tend to use financial statements in the same way as outside shareholders, because they are generally more aware of the position of the company as a result of their day-to-day involvement. This involvement results from the fact that in most private companies the shareholders and the directors or managers are the same persons, who have full access to the accounting books and monthly management reporting so as to satisfy their information needs (Hattingh 2001:35). This is the reason why the financial statements of the small entity will be used to assist the shareholders/directors not only in determining compliance with any statutory regulations, but also in managing, controlling and developing the business (Cilliers, Benade *et al.* 2000:657).

This statement is endorsed by Lippitt & Oliver (1983:54), who stated that the management of a small business is often the responsibility of one or a few individuals. These individuals fulfil multiple management roles, which makes the typical small business manager familiar with most aspects of the business. Accordingly, such managers would be less dependent upon formal financial information than their counterparts in larger businesses. In addition, owners of small businesses are generally more closely involved in management and thus have greater access to internal information than is true in the case of large businesses. This tends to make small business managers less dependent upon formal financial statements.

The above-mentioned statement is also applicable to the members of close corporations, because the members usually fulfil the role of both owner and manager of the close corporation. It is therefore concluded by Hattingh (1999:33) that the purpose of communicating to these members is to enable them to monitor, measure and manage the operations of the close corporation.

In the empirical research study the opinion of the members of close corporations on the purpose of their financial statements were tested. They were asked the following questions:

- How dependent are you on financial statements to gather managerial information, on a scale from one to ten, with one representing not dependent and ten very dependent;
- Do financial statements provide you with useful information for:

- Planning;
- Decision-making; and
- Control?

- Please specify the information that you either find useful or not useful at all; and
- Rate the following uses of your financial statements in order of importance, on a scale form one to ten, with one equalling not important and ten very important:
  - As a tool for calculating taxation;
  - As a tool in raising loan finance;
  - As a source of management information;
  - As a source of financial information for decision-making purposes; and
  - Other (please specify).

The results, as illustrated in chapter 5, show that 55% of respondents are very dependent on financial statements for managerial information, giving a rating of seven and higher out of ten. Of the remaining 45%, 11% were indecisive with a rating of five out of ten. Furthermore, only 50% of the respondents replied that financial statements provide them with useful information for planning and decision-making purposes, while the majority of respondents stated that financial statements do not provide them with useful information for exercising control.

A reason for these results may be that different accounting systems are being used for record-keeping purposes. The different accounting systems either result in the availability or unavailability of additional information for managerial purposes. The information specified by the respondents as being useful, can be summarised as follows:

- Cost and production information for expansion purposes;
- Cost centre information;
- Cash flow and statements of expenses/income;
- Division of statements into different sections to determine areas that do not perform; and
- Information about budget & sales.

The majority of the above information is, however, supplementary information that is not usually disclosed in financial statements. This furthermore illustrates that the financial statements may already be tailored to suit the needs of the members.

The results also show that 80% of the respondents regard the use of financial statements as a tool for raising loan finance and tax calculation as very important, with a rating of six and higher out of ten. Nevertheless, 60% of the respondents also regard the use of financial statements as a tool for decision-making and gathering management information as important, with a rating of seven and higher out of ten. It can thus be concluded that all four uses of financial information, namely as a tool for raising loan finance and for assisting tax calculation, as well as a source of decision-making and management information, are regarded as important by the members of close corporations.

On the other hand, some of the respondents replied that they do no use financial statements at all. Some stated that statements are provided much too late to be worth anything. It can therefore be concluded that some, but not all, members of close corporations do not find the current form of financial statements useful.

These results confirm the statement made by the United Nations Trade and Development Board (2000:7), namely that in the minds of many, if not all small business entrepreneurs, accounting is seen primarily as a tool for calculating taxation. After taxation, its next use is seen as a requirement for raising loan finance. The positive use thereof as manifested in the provision of a model of the company to enable it to become more profitable and more manageable, is generally not understood or even underrated. Many small and medium-sized enterprises (SMEs) are neither aware nor convinced of the usefulness of accounting and financial reporting requirements for control and decision-making purposes (United Nations Trade and Development Board 2000:5).

In the empirical research study, the members of close corporations were also asked how useful they find the current form of financial statements and to rate the following sources of managerial information in order of importance, on a scale from one to ten, with one equalling not important and ten designating very important:

- Income statement and notes prepared according to GAAP;
- Balance sheet and notes prepared according to GAAP;
- Cash flow statement and notes prepared according to GAAP;
- Income statement prepared according to tax rules;
- Cash flow forecasts; and
- Other.

The results can be summarised as follows:

- 70% of the respondents regard the current form of their financial statements useful, with a rating of six and higher out of ten;
- 60% of the respondents replied that the income statement, balance sheet and notes prepared according to GAAP are important sources of managerial information, with ratings of eight and higher out of ten, and another 10% are indecisive with a rating of five out of ten;
- 50% of the respondents replied that cash flow forecasts are an important source of managerial information, also with a rating of eight and higher out of ten;
- 50% of the respondents replied that the income statement prepared according to tax rules are an important source of managerial information, with a rating of seven and higher out of ten and another 10% are indecisive with a rating of five out of ten;
- only 30% of the respondents regard the cash flow statement and notes prepared according to GAAP as an important source of managerial information, with a rating of nine and higher out of ten and another 30% are indecisive with a rating of five out of ten.

It can be concluded from the above results that the cash flow statements and notes prepared according to GAAP are not regarded as an important source of managerial information. The other sources are either regarded as important or not important for managerial information by an equal number of respondents.

A further difference investigated between the owners of large public companies and those of smaller entities, is that of concentration of ownership. The typical small business owner tends to be less diversified, with most of the business capital committed to a single small business. Accordingly, the owners are interested in periodic information about total risk, rather than the systematic risk that interests diversified investors, because all, or most, of their assets are invested in one business. As a result of this concentration of ownership, the capital market for small businesses is much "thinner" than for large ones (Lippitt & Oliver 1983:54).

This lack of large numbers of active buyers and sellers also suggests several differences. Any given trade is likely to represent a substantially larger proportion of the total ownership, and relatively few changes in ownership may make frequent, regular financial reports less appropriate. On the other hand, thinner financial markets may not be "efficient." This can require the parties to rely even more strongly on whatever accounting information is available (Lippitt & Oliver 1983:54).
This view is also supported by Cleminson & Rabin (2002:335), who stated that when an acquisition or sale of an ownership interest in the enterprise occurs, the potential investors will use the financial statements to aid them in their decision-making. They, however, further stated that their limited access to relevant information is usually expanded by agreement as a part of the due diligence process.

In order to identify the importance of the financial statements to provide useful information when an acquisition/sale of an ownership interest in the close corporation occurs, the members of close corporations and CFAs were asked in the empirical research study to identify from the three options below, which would be the most important source of information when an acquisition/sale of an ownership interest occurs, and further to specify the other information used:

- Financial statements;
- Other information; or
- Both.

The majority of respondents replied that both financial statements and other information are used. The following other information was specified:

- What the purchase price is made up of;
- Equity and loan information;
- Statutory documents;
- Location;
- The type of business;
- Members of the close corporation;
- Cash flow projections;
- Business plans;
- Valuations based on previous financial statements;
- Projected cash flow and price earnings of similar companies for the future;
- Details of asset valuation and earning potential;
- Marked trends – competition, etc;
- Calculations of goodwill;
- Calculation of members' interest valuation;
- The "real figures"
- Market trends;
- Bank statements;
- Invoice/cash sales;
- History in terms of capital growth/tax; and
- Day-to-day turnover trends.

It can be gathered from the above information that even if the financial statements of close corporations are prepared according to the requirements of the Statements of GAAP, there is still an amount of additional information required to satisfy the needs of the owners of close corporations in the event of an acquisition or sale of ownership interest.

Therefore, total assurance will not be obtained from compliance with the Statements of GAAP when an acquisition or sale of ownership interest occurs.

Finally it can be concluded from the above-mentioned discussions that the information needs of the owners of close corporations and other small entities differ from those of large public enterprises. These differences in information needs mainly result from the differences in the relationship between the owners and management of large public companies, compared to the relationship existing in close corporations and other smaller entities. These differences imply that in small entities the owners are mostly involved in the day-to-day management of the business, resulting in less reliance being placed on formal financial statements. It was even gathered from the empirical research study that some members of close corporations do not find the current financial statements useful at all.

Even so, the empirical research study also revealed that the members of close corporations regard the uses of financial statements, namely as a tool for raising loan finance and assisting in tax calculation, as well as for decision-making and presenting management information, as important. This proves that the financial statements of close corporations are still regarded as important by the members, illustrating the need for review of the accounting requirements for close corporations.

In the next section, the information needs of the tax authorities, also one of the main user groups of the financial statements of close corporations, are discussed. This discussion will illustrate the difference in the information needs of the different user groups and will analyse the usefulness of the current form of financial statements for tax authorities.

2.4.2.2 Tax authorities

In the opinion of the ASB (1996:14), the tax authorities are interested in profit measurement. The purpose of communicating with the SARS, according to Hattingh

(1999:33), is to enable it to assess the entity for various taxes. For this purpose, the financial statements are used to support the tax calculations for the small business entity. However, the enterprise may have to submit supplementary schedules to the South African Revenue Services (SARS), e.g. with regard to repairs and maintenance expenses (Cleminson & Rabin 2002:335). Also, SARS can, and does when required, call for any information it needs to enable it to assess a company for tax purposes (Hattingh 2001:35).

In the empirical research study the personnel of SARS were questioned on whether they request additional information to supplement the financial statements of close corporations, and if so, to specify. According to 52% of the respondents, they request additional information. The information specified can be summarised as follows:

- Trial balance and general ledger;
- Debtors and creditors' lists;
- A list of the inventory at year end;
- Fixed asset register;
- Bank reconciliation;
- A full analysis of the loan accounts of members;
- Sales invoices;
- Purchase invoices;
- The salaries and wages register and all other relevant information regarding salaries, i.e. PAYE with fringe benefit details;
- Bad debt with reasons;
- VAT working papers;
- A detailed analysis of expense and revenue accounts, as well as documentation to support the entries in them is usually requested in the tax return, but not supplied; and
- In cases where the close corporation's year end differ from that of members, a reconciliation is needed between the figure accrued to the member until 28/02 and the amount applicable to the other period.

The following can be deduced from the above-mentioned results: irrespective of compliance with the requirements of the Statements of GAAP in the financial statements of close corporations, some more additional information will still be requested by SARS to fulfil their specific information needs for tax-assessing purposes.

The reality therefore is that the accounting rules and tax rules differ significantly. This is why Hattingh (2001:35) supposed that the Statements of GAAP do not help SARS, as there are many accounting rules in these statements that must be reversed when calculating tax. He discussed this problem of compliance with the Statements of GAAP with the corporate assessors at SARS in their offices in Randburg and they were generally in agreement that compliance with the Statements of GAAP would not be of assistance in assessing companies for tax. They would be happy if companies could comply with tax laws in their financial statements. It was further stated that as most companies in SA only prepare financial statements for tax purposes, it seems illogical to prepare them also for "general purpose users" (Hattingh 2001:37).

In order to determine SARS' view on the effect of non-compliance with the Statements of GAAP in the financial statements of close corporations on the tax-assessing process, it was tested in the empirical study. The majority respondents replied that non-compliance with the statements of GAAP would not influence the tax-assessing process. The concerns raised by those who replied that the assessing process would be influenced, are the following:

- More physical audits will have to be conducted;
- Income can be understated and expenses overstated;
- The quality of the financial statements will not be up to standard and could therefore cause the number of queries to increase;
- Some important information will then not be shown;
- The accountants will only declare what they like; and
- There will be no standard format for the production of financial statements.

Most of the above-mentioned concerns relate to the credibility of the financial information. Some of the respondents even replied that they assume that the financial statements are reliable as the statements have to be drawn up by an Accounting Officer, who, according to them, laid down an oath that the financial statements will be accurate, correct and precise. However, the credibility of financial information is not guaranteed by compliance with the Statements of GAAP as reflected in the financial statements of close corporations. Similarly, non-compliance with the Statements of GAAP will not necessarily imply less credible financial information.

The views of the personnel of SARS on the usefulness of the financial statements of close corporations were further explored with a number of other questions included in the empirical research study, namely:

- How useful do you find the current financial statements of close corporations for tax assessment purposes, on a scale from one to ten, with one equalling not useful and ten very useful?
- How dependent are you on the financial statements of close corporations for tax assessment purposes, again on a scale from one to ten, with one equalling not dependent and ten very dependent? and
- Do the financial statements of close corporations provide you with useful information for tax assessment purposes, and specify the information that you either do or do not find useful.

The results, as illustrated in chapter 5, show that 89% of the respondents regard the current form of financial statements useful for tax assessment purposes, with a rating of six and higher. The remaining 11% are indecisive, with a rating of five. The majority of personnel also replied that they are very dependent on the financial statements of close corporations for tax assessment purposes, with 90% of the respondents giving a rating of six and higher. Again, the remaining 10% are indecisive with a rating of five.

In response to the third question as stated above, the majority of respondents replied that financial statements provide them with useful information for tax assessment purposes. The useful information specified is summarised as follows:

- Income and expenses;
- Fixed and current assets;
- Register of assets;
- Depreciation schedules;
- Current and long-term liabilities;
- Stock on hand;
- Tax computations;
- Loan accounts of members;
- Interest and remuneration paid to members;
- Salaries paid;
- Cash flow statement, income statement with notes and the balance sheet;
- Declaration of dividends and also the declaration of STC; and
- The showing of further information for tax purposes like the names of members and members' fees paid.

On the other hand, some respondents mentioned that the tax reference numbers of members do not appear on the records, but are regarded as important for tax assessment purposes. This illustrates the unique information needs of the personnel of SARS. Accordingly, it can be gathered from the above responses that the information needs of SARS are quite different from the needs of the members that were previously discussed.

In conclusion, the IASB (2004:19) stated that tax authorities often look at financial statements as the starting point for determining taxable income. For this reason the credibility of the financial statements of close corporations is of high priority to the personnel of SARS. It is furthermore believed by them that credibility of information in the financial statements will generally be achieved by compliance with the Statements of GAAP. Accordingly, the usefulness of the information provided in the financial statements of close corporations for tax assessment purposes is dependent on the believed credibility of that information.

Another user group that highly values the credibility of the financial statements of close corporations is bankers. Their information needs are analysed in the following section.

2.4.2.3 Banks and creditors

An admission is made by the United Nations Trade and Development Board (2000:8) that small and medium-sized enterprises (SMEs) are very dependent on banks and other creditors for financing their operations, because of their limited access to capital markets. The limited access to capital markets often makes the role of bankers and other short-term creditors quite significant (Lippitt & Oliver 1983:54).

The above-mentioned statement is also expressed by Abdel-Khalik, *et al.*, as quoted by Kent & Munro (1999:361), namely that loan officers are regarded by some as the most important external user group of private company financial reports. This statement is confirmed by a research report published by CICA, "Financial Reporting by SBEs". In this report it is stated that small business enterprises prepare GAAP financial statements primarily to meet the needs of their bankers, and even though these needs have changed in recent years, financial statements still play a major role in the decisions of bankers concerning large loans where the cash flows of entities will provide for repayment (Lavigne 1999:49).

In the opinion of Cleminson & Rabin (2002:335), compiled financial statements are usually sufficient for the analysis of credit suitability for small loans, while the decisions of bankers to advance large loans are primarily based on cash flow information derived from annual financial statements. In the last scenario, the credibility of financial statements is essential and bankers would require assurance of GAAP compliance. Banks would also require information about liability disclosures and asset values (ASB 1996:14).

The information needs of creditors and potential creditors are detailed by Ivancevich *et al.* (1997:25). They explained that creditors and potential creditors tend to focus more heavily on the ability of a company to meet its debt obligation than on earnings because of the short-term nature of money loans. Marriott (1997:33) also explained that creditors are more likely to place reliance on credit and personal references, an evaluation of personal attributes and the past trading record of directors/members. Accordingly, it is assumed by Lippitt & Oliver (1983:54) that short-term creditors often require systematic financial reporting information, resulting in a case being made for making the focus of small business financial reporting the liquidity information needs of their short-term creditors, not general purpose GAAP.

The view of bankers on the importance of financial statements for credit analysis purposes was tested in the empirical research study by posing the following questions:

- How useful do you find the current financial statements of close corporations for credit analysis purposes, on a scale from one to ten, with one equalling not useful and ten very useful;
- How dependent are you on the financial statements of close corporations for credibility information, again on a scale from one to ten, with one equalling not dependent and ten very dependent; and
- Do the financial statements of close corporations provide you with useful information for credit analysis purposes, and specify the information that you either do or do not find useful.

The results, as illustrated in chapter 5, show that 86% of the respondents find the current format of financial statements useful for credit analysis purposes, with a rating of six and higher out of ten. All the respondents replied that they are dependent on the financial statements of close corporations for credibility information, with 57% of the respondents giving a rating of ten out of ten, and all the respondents replying that the financial statements of close corporations provide them with useful information for credit analysis purposes. The useful information specified can be summarised as follows:

- Description of fixed assets, i.e. types and structure;
- Types and structure of liabilities to determine how much outside debt the client has, namely at other financial institutions;
- Contingent liabilities;
- The details of bankers;
- Confirmation of drawings and the capital account, i.e. how much money is invested in the business;
- The loans of members;
- Solvency, liquidity and gearing ratios;
- Cash flow information by looking at the debtors and creditors' list and the time it takes the client to pay his creditors and to collect his money from his debtors;
- The repayment ability of the client;
- The turnover and expenditure of the close corporation;
- Comparison of turnover and profits on a year-to-year basis;
- Trends that can be identified; and
- The balance sheet in general.

It can be concluded from the above responses that the Statements of GAAP are not needed by bankers in order to present this useful information in the financial statements of close corporations. In the opinion of Hattingh (2001:35) bankers have to adjust the financial statements of companies, whether or not the Statements of GAAP are applied, because these statements do no fully meet the needs of credit risk analysts. According to him, in most private companies, bankers usually take collateral and do not fully rely on the financial statements to make advances, and credit analysts can, and do, call for further information to help them in their assessment of credit risk.

Hattingh (2001:37) discussed the problem of compliance with the Statements of GAAP with personnel at the credit departments of two large banks. The personnel responded by confirming that they usually call for further information from the companies when assessing the companies for credit risk. They realise that even if companies should fully comply with the Statements of GAAP, they would still have to call for further information as GAAP does not provide all the information required to assess credit risk. They are also concerned that the cost of compliance would reduce the profits of companies required to cover their interest and loan/overdraft repayments.

However, according to Stanga *et al.*, as quoted by Kent & Munro (1999:361), research evidence suggests that loan officers prefer financial reports that apply all accounting standards and regulations, because the primary concern of loan officers is to obtain useful, reliable and comparable information. They want "assurance" that the financial reports being evaluated can be relied upon. The application of GAAP provides this reliance and bank loan officers indicated that deviations from GAAP will:

- dilute the credibility of financial reports;
- make it more difficult to finance through debt; and
- increase the possibility of making a loan that subsequently defaults.

Kent & Munro (1999:361) supported this evidence by expressing the opinion that financial reports prepared under GAAP can be viewed as having complied with the regulated set of accounting measurement rules and as a consequence provide the highest degree of credibility. This implies that the presentation of financial reports applying all applicable accounting standards to a loan officer indicates that a certain level of reliance can be placed on the accounting numbers as a result of full compliance.

In order to determine whether non-compliance with the statements of GAAP in the financial statements of close corporations will influence the decision of bankers to provide loan facilities to the close corporations, the question was included in the empirical research study. In agreement with the above opinions, the majority of personnel of the bankers that responded, replied that non-compliance with the Statements of GAAP will influence their decision, because the credibility of the information will also be in question.

The above-mentioned results are confirmed by other survey evidence, particularly from the US, that bank lending officers would be unhappy with differential reporting. According to Walton (1992:47), banks rely on the balance sheet more than on the profit and loss account, and are looking for details of liabilities and commitments. However, it is not self-evident that modified small company GAAP would not provide liability information.

Walton (1998:2) further expounded that banks and other lenders use the annual statements only for *ex post* confirmation, with lending decisions based on budgets and monitored by means of management data. In the opinion of Marriott (1997:33), banks even undertake their own "mini-audit" of particular director-shareholders, reviewing factors such as business standing and acumen, personal wealth and the ability to offer personal guarantees and security. Furthermore, banks also have access to the cash flow behaviour of a small company by scrutiny of their files and can ask for further, more up-to-date, information if they are concerned about the withdrawal patterns of a company.

In order to determine whether the personnel of bankers request additional information to supplement financial statements, this question was asked in the empirical research questionnaire distributed to the personnel of bankers. They were also asked to specify the additional information they request.

The results were almost equal with 57% of the respondents replying that they request additional information. The following additional information was specified:

- Asset register;
- Debtors and creditors' list;
- Management accounts;
- Assets and liabilities of the members of the close corporation in their personal capacity;
- The personal financial position of members;
- Credit bureau checks on the close corporation and its members;
- The available security they can offer;
- Cash flow projections for a year; and

- Management accounts if the balance sheet are older than 6 months.

As in the case of SARS, it can be concluded from the above responses that bankers and other creditors also have unique information needs that will not be fully met by the compliance of financial statements with the Statements of GAAP. They also require specific additional information.

It can therefore be concluded that although bankers need additional information, they still prefer financial statements prepared in compliance with the requirements of the Statements of GAAP for credit analysis purposes. This is mainly because of the believed inherent credibility of the information. Accordingly, non-compliance with the Statements of GAAP in the financial statements may negatively influence the ability of a close corporation and other small entities to obtain the necessary financing.

It is clear from the discussions on the purpose for which users require information that even though the different user groups have different information needs, the financial statements still play an important role in providing the necessary information to users. Accordingly, the above-mentioned information needs of the different user groups should be taken into account when developing reporting standards for close corporations.

2.4.3 To summarize

It can be concluded from the discussion on the users of financial statements that close corporations and other small entities do not have the same financial reporting needs as large companies, because they differ in their ownership interests, management, and the role of external parties (Koppeschaar 2002:2). The users of financial statements, the purposes they use the financial statements for and the relationship among stakeholders in close corporations and other small entities are typically quite unlike those in large companies, and there is much less public interest in their activities (Murphy 1998:64).

In this regard, accountants became increasingly aware of the special and specific needs of small businesses (Burton & Hillison 1979:16). They realised that the complex calculations involved and the amount of disclosure frequently required often make the financial statements of close corporations and other small entities incomprehensible to their users, because they are being compelled to disclose information to their members/shareholders irrespective of the usefulness or relevance thereof (Koppeschaar 2002:2).

This realisation resulted in the development of differential reporting. The differential reporting principle acknowledges that the information needs of users of financial statements of non-public entities differ from the information needs of the users of financial statements of public entities (Mersereau 2002:32). In order to gain a deeper understanding of the reasoning behind the differential reporting concept, the Statements of GAAP and its applicability to close corporations and other smaller entities should first be understood. This is discussed in the next section, together with some background on the proposed Limited Purpose Financial Reporting Standards (LPFRS) as differential reporting principle in SA.

2.5 Statements of GAAP

It was concluded from the previous sections that financial statements are produced in response to the varying needs of users. The answers to the questions: "Whom are they meant for?" and "What do those people need them for?" and other related questions, have shaped the development of accounting and reporting practices worldwide (Nexia International 1997:3).

These developments have resulted in a spectrum of accounting systems. At one extreme is what might be called the "legalistic" framework, where financial statements are compiled in accordance with a rigid set of rules, irrespective of whether adherence to these rules contradicts the commercial realities. At the other extreme is the "commercial" framework where the only inviolable rule is that the financial statements must give a clear and realistic picture of the performance and financial position of the reporting company. The distinction between the two is being blurred by the trend towards international harmonisation, a trend that is being driven by macro-economic factors such as the arrival of a single European market, the globalisation of securities trading and the increase in the size of securities markets throughout the world (Nexia International 1997:3).

In South Africa (SA) there are two financial reporting frameworks currently, the one based on generally accepted accounting practice (gaap) and the other based on the Statements of GAAP. The essential differences between these two bases of accounting are the following (SAICA 2000:2):

- Statements of GAAP are those accounting standards and practices which have been codified by the responsible standard setting body in SA, namely the Accounting Practices Board (APB). These accounting standards are based on internationally accepted standards, and compliance therewith would ensure fair presentation in the financial statements and compliance with sect. 286(3) of the Companies Act; and
- Generally accepted accounting practices includes those accounting practices which are uncodified, but are regarded as being generally accepted due to their being followed by a number of companies. These practices may or may not comply with the Statements of GAAP, but would be the minimum required to meet the requirements of sect. 286(3) of the Companies Act, provided fair presentation is achieved.

The South African Statements of GAAP have developed on a piecemeal basis. Until 1990, the main point of reference for standard setters was the first version of AC101, which dated back to 1974, and provided four basic concepts for the development of accounting policies. In 1990, the conceptual framework developed by the International Accounting Standards Committee (IASC) was adopted in SA. This framework served as a basis for revising existing statements and producing new ones (Everingham, Kleynhans & Posthumus 2003:3). Then in 1993, the Board of SAICA and the APB approved that the

Statements of GAAP should henceforth be based on International Accounting Standards (IAS) (Coetzee 2001:11).

The APB consists of various representatives from different sectors of commerce (Coetzee 2001:7). The Board was formed in 1973 under the auspices of the then National Council of Chartered Accountants (SA), now the SAICA, with the principle objective of establishing and procuring the negotiation and acceptance of what it considers to be or should be generally accepted accounting practice as part of the standard setting process (Symington 1986:70).

The standard setting process in SA proceeds as follows: SAICA, by means of its Accounting Practices Committee (APC), prepares statements for consideration by the APB (Everingham, Kleynhans & Posthumus 2003:1). Then the APB, following a process of drafting and exposure to the SAICA, approves the Statements of GAAP (Coetzee 2001:7).

This approach which was adopted in the setting of accounting standards aimed at identifying those accounting practices that are desirable and thereby narrowing the difference between and variety of available accounting practices without attempting rigid uniformity in the production of an inflexible set of rules for all circumstances. The objective is to produce standards that have as general an application as possible but which are geared to eliminate undesirable alternatives. According to AC 100, this process may well go further than codifying existing practice (SAICA 1983:par06). This approach is confirmed by Skinner, as quoted by Everingham & Hopkins (1993:2) who stated that an accounting method should meet at least one and usually more of the following conditions to qualify as GAAP:

- actual use in a significant number of cases where circumstances are suitable;
- the support of official pronouncements; and
- authoritative support in the accounting literature.

The purpose of this approach used in the standard setting process is to ensure that the Statements of GAAP achieve their objective. The objective of GAAP, as stated by Pietersen (1992:53), is to aspire to smoothing the communication process of accounting by limiting the variety of accounting practices and sometimes spelling out undesirable practices. It should further be used to identify desirable practices and to assist preparers of financial statements in meeting the overriding requirement of fair presentation by the coverage of both disclosure requirements and principles of measurement with the latter applying to any financial statement which purports to achieve fair presentation (Everingham & Hopkins 1993:3).

This last statement, namely that the principles of measurement should apply to any financial statement which purports to achieve fair presentation, results in the question whether the principles of measurement contained in the Statements of GAAP are applicable to the financial statements of close corporations. This is because of the overriding requirement of fair presentation for the financial statements of close corporations, as described in the Close Corporations Act No. 69 of 1984, sect. 58. This question is discussed in the following section.

2.5.1 Applicability of the Statements of GAAP to close corporations

In the opinion of Prinsloo (2000:4) the Statements of GAAP define the reporting standards applicable to enterprises that produce general purpose financial statements, and these statements are defined in AC101 as those intended to meet the needs of users that are not in a position to demand reports tailored to meet their specific information needs. This opinion is further elaborated on by Hattingh (2001:35), who stated that the Statements of GAAP were developed for "reporting enterprises" which are defined in the accounting framework as enterprises "for which there are users who rely on the financial statement as their major source of financial information about the enterprise".

According to Prinsloo (2000:4), these "reporting enterprises" generally have a diverse ownership profile, a clear distinction between ownership and stewardship, access to capital markets and equity interests that can easily be traded. Furthermore, the users of the financial statements of these enterprises are providers of capital, be they suppliers, equity investors or other groupings. Accordingly, it is concluded by Heymans (2000:31) that accounting standards are designed to protect the interests of these parties and to guarantee full transparency of the financial reports they receive.

It is, however, claimed by some that financial statements of a small entity produced in accordance with these standards can be incomprehensible to many users, often the owner-managers themselves who are seeking to understand and confirm the performance of their business during the financial year concerned (Sleigh-Johnson 2001:92). The reason for this being that some of the complex rules that are in force currently, may serve to hinder communication and not aid it. The complex calculations, the amount of disclosure and the technical terminology frequently called for by accounting standards can serve to make the financial statements of small entities incomprehensible to their users (Wild & Carter 1995:80).

According to Davies, Paterson & Wilson (1989:13), the main cause of the incomprehensibility of the financial statements of small entities for their users is the fact that general purpose financial statements are prepared on the assumption that there are no basic differences between the needs of those who use them. However, the key difference is that the vast majority of enterprises are closely held and controlled by their owners or stakeholders and that the financial statements of these enterprises are not distributed for general use, but only made available to a limited number of interested parties who are all in a position to demand further information for their specific needs (Garbutt 1999:29).

According to Heymans (2000:31), the pivotal issue is that the financial statements of enterprises are either produced for general use, typically those of publicly trading enterprises, or for limited use, typically owner-managed enterprises. Financial reports that are not produced for general use are only distributed to a limited group of selected individuals or parties with an ownership, business, management or tax interest in the enterprise and accordingly fall outside the scope of general purpose financial statements.

The limited distribution characteristic is also one of the characteristics of a close corporation (Prinsloo 2000:4) and forms the basis of the exemption of the financial statements of close corporations from the Statements of GAAP, as recommended by SAICA in their revised "Guide on Close Corporations" (SAICA 2001:8). This revision, however, leads in the following question: What are the accounting requirements for the financial statements of close corporations?

The financial statements of close corporations are regulated by the Close Corporations Act. At present, the Close Corporations Act No. 69 of 1984, sect. 58(2b), requires that the financial statements of a close corporation should conform with generally accepted accounting practice appropriate to the business of close corporations, and should fairly present the state of affairs of the close corporation as prevalent at the end of the financial year concerned, and the results of its operations for that year (compare Everingham & Kana 2004:248).

The requirements of the Close Corporations Act are further elaborated on by Everingham & Kana (2004:248) who state as follows:

- In interpreting "conformity with generally accepted accounting practice appropriate to the needs of the business", the opinion of Counsel regarding the standing of the Statements of GAAP is that they provides useful guidance. The requirement of fair presentation will nevertheless involve a high measure of compliance with the Statements of GAAP; and
- In deciding what is "appropriate for the business", the trading and operating activities of the close corporation and the generally accepted accounting practices prevalent in its environment should be considered.

It is further concluded by them that absolute compliance with the Statements of GAAP will almost always result in fair presentation.

On the other hand, in the opinion of Everingham, Kleynhans & Posthumus (2000:3), it may not be necessary to apply the Statements of GAAP rigidly to close corporations as far as disclosure is concerned, because in practice the financial statements of close corporations usually include a detailed income statement, which amounts to more than that which is provided by public companies. In addition, the Statements of GAAP apply to the financial statements only insofar as their effect will be material. According to Cilliers, Benade *et al.* (1993:76), financial statements need not disclose information that is immaterial to fair presentation. Nevertheless, according to Everingham, Kleynhans & Posthumus (2000:3), the underlying principles of measurement set out in GAAP statements should be followed by close corporations.

The problem of determining whether compliance with the formal Statements of GAAP is in fact necessary in order to ensure that the annual financial statements do in fact comply with the Close Corporations Act requirements, is analysed by Cilliers, Benade *et al.* (1993:76). According to them, it stems from the inherent vagueness of the essential attributes of a close corporation. The most important element to which it is admitted not sufficient attention was paid by the legislature, is that the only limiting requirement for the formation of a close corporation is that its membership should be limited to a maximum of ten natural persons. No limitation is placed on the size of the financial resources of the corporation or the complexity of its business. In the case of complex business transactions being conducted, complex accounting knowledge is required to process the transactions involved accurately. This means that time and money are spent unnecessarily on financial statements that are only distributed to a limited number of users.

Even though the possibility exists that complex business transactions could be included in the financial statements of close corporations, there is still only a limited number of users of the financial statements of close corporations with specific information needs. As was previously stated, the information needs of these users should form the basis of the requirements financial statements and the concomitant accounting requirements.

According to Prinsloo (2000:4), the solution to the problem of accounting requirements for close corporations lies in the fact that the users of the financial statements of close corporations and other small entities do not require the extensive information provided in general purpose financial statements. Consequently, an accounting standard is required to differentiate between general and limited purpose financial statements. These limited purpose financial statements are elaborated on in the next section.

2.5.2 Limited purpose financial statements

The need for an accounting standard that differentiates between general and limited purpose financial statements was identified in the previous section. Prinsloo (2000:4) elaborated that these limited purpose standards should not be dealt with separately but should be an integral component of the Statements of GAAP. However, in the opinion of Coetzee (2001:11), the proposed accounting statement on limited purpose financial statements (LPFS) that is an integral part of GAAP, warrants some additional discussion. According to him, if the emphasis is on "limited" and on enterprises not just governed by the Companies Act, but also by the Close Corporations Act, it seems that LPFS should be excluded from GAAP. The reasoning behind this opinion emanates from the fact that it is no longer a requirement for close corporations to comply with the Statements of GAAP in their financial statements (SAICA 2001:8).

The empirical research study investigated the opinions of the CFAs and the members of close corporations regarding the question whether close corporations should have their own separate set of accounting standards to comply with. Only 40% of the members that responded, replied that close corporations should have a separate set of accounting standards. The majority of the CFAs that responded, however, were of the opinion that close corporations should have a separate set of accounting standards.
The respondents were furthermore asked regarding the form the separate set of accounting standards should take and responded by proposing the following:

- A separate accounting standard for smaller entities; or

- Differential reporting listed in each statement.

The option of a separate set of accounting standards for smaller entities is preferred by 75% of the respondents. It can therefore be concluded that differential reporting listed in each statement is not the correct option in the opinion of the respondents. The separate set of accounting standards is also the method used by SAICA in the proposed limited purpose financial reporting standards (LPFRS) as set out in ED 163, which was published in June 2003.

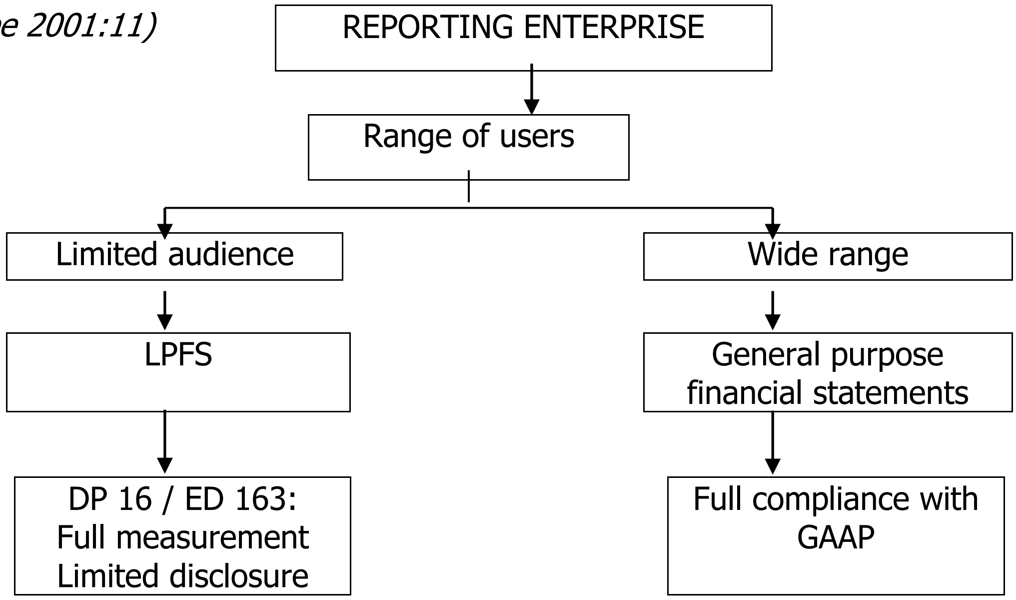
In ED 163 the LPFRS were prepared according to the following guidelines (SAICA 2003:15):

- Underlying assumptions;
- qualitative characteristics of financial statements;
- the elements of financial statements;
- recognition and measurement criteria; and
- the concepts of capital and capital maintenance;

as set out in the IASB Framework, and adopted in SA as AC000. Although the LPFS is only a proposed accounting statement and can still be changed drastically, the reasoning underpinning this proposal can be presented as follows:

Figure 3: Limited purpose financial statements (LPFS)

(Coetzee 2001:11)



It can be seen from the above diagram that the only allowance made with regard to limited purpose financial statements relates to the disclosure requirements. The reason for the limitation on the exemption of certain recognition and measurement requirements is the overriding requirement of fair presentation as required by the Close Corporations Act. Further detail on the proposed LPFRS is presented in chapter 4.

To summarize, the goal of GAAP, as stated by Vorster, Koen *et al.* (2003:12), is to ensure that the financial statements give a true and fair view of the financial results for a specific period and the financial position of an entity on a specific date, and that the financial statements of different entities are more easily comparable. It should, however, be noted that the Statements of GAAP were primarily developed for public reporting enterprises, while the financial statements of the vast majority of owner-managed businesses in SA are not prepared for general use (Cleminson & Rabin 2002:333).

This distinction between general purpose and limited purpose financial statements was recognised by accountants and resulted in the development of LPFRS in SA. In the LPFRS it is, however, mostly the disclosure requirements that are limited. The limiting factor on the modification of certain recognition and measurement requirements is the overriding requirement of fair presentation. The meaning of fair presentation as overriding requirement for the financial statements of close corporations is further analysed in the next section.

2.6 Fair presentation

According to Everingham & Kana (2004:5), the predominant requirement in the presentation of financial statements of close corporations is to fairly present the financial position, performance and cash flow of the enterprise. Even though the concept of fair presentation is not new to accounting literature, it is one that is by its very nature, one of the most difficult to apply (Vorster, Koen *et al.* 2003:31). The reason for this is the fact that neither the Companies Act nor the Close Corporations Act defines fair presentation (Pain & Blakemore 1997:12). In the following section a possible definition of fair presentation is discussed.

2.6.1 Definition of fair presentation

In the opinion of Flint, as quoted by Lee (1982:16), the vagueness which is due to the consistent lack of definition, despite its juris-prudential source in the form of the Companies Act and Close Corporations Act stipulations, is the very strength of the concept of fair presentation. This contributes to some flexibility in the interpretation of the concept. Some of the possible interpretations are summarised as follows:

- According to Vorster, Koen *et al.* (2003:19), "faithful representation" means that the information that is disclosed in the financial statements will give a faithful representation of the events it purports to represent, or would reasonably be expected to represent. All items that impact on the financial position and/or results of an entity should be represented in the financial statements in an appropriate manner. Faithful representation thus refers to the nature of the information contained in the financial reports.

- Tweedie, as quoted by Parker & Nobes (1994:ix), stated that the true and fair view reflects the broad consensus of the financial community on the amount, nature and form of the presentation of information at a particular moment in time. It is an ambulatory concept changing gradually over the years as further information is required and new accounting practices develop.
- In the opinion of Fowle (1992:29), the phrase "true and fair" embodies the concepts of consistency and prudence, and requires the preparer and auditor to consider the substance of the transactions entered into by the group, individually and as a whole, in order to conclude whether the picture the accounts present, realistically reflect those transactions in a way which is balanced and relevant to the needs of the reader.
- According to Flint, as quoted by Ekholm & Troberg (1998:115), the true and fair view has a conceptual quality of great merit, because it recognises the cultural dependence on accounting and financial reporting, and the fact that it is evolving continuously to meet the needs and expectations of the changing social and economic environment. What is perceived to be a true and fair view is ultimately a matter of ethics or morality.
- According to Reid & Myddelton (1992:5), "true and fair" accounting is a technical phrase meaning appropriate classification of items and the consistent application of generally accepted accounting principles.
- In the opinion of Alexander & Britton (1993:211), “true and fair” means whatever the accounting profession currently thinks it means. The lack of definition contributes to the precise meaning of true and fair being different at different moments in time. The "normal" view becomes by definition the "acceptable" view.

The above interpretations illustrate the flexibility of a definition of fair presentation. It can further be concluded that the concept of fair presentation is adaptable to the evolution of accounting principles. The flexibility of the definition results in the following problem experienced with the requirement of fair presentation, namely the practical application of the concept. The question that emanates, is: how will fair presentation be achieved in the financial statements of close corporations? This question is discussed in the following section.

2.6.2 How will fair presentation be achieved?

In SA, the Statements of GAAP issued by the APB are aimed at achieving fair presentation. Legal opinion noted that, having regard for the procedure adopted by the APB in considering and approving statements and the composition of the APB, to the extent that if a company in drawing up its financial statements were to comply with such statements, it could "safely (be) assume(d) that they have complied with the provision of fair presentation in this respect" (Pain & Blakemore 1997:12). Accordingly, it is concluded by Vorster, Koen *et al.* (2003:32) that by complying with the Statements of GAAP, fair presentation is usually accomplished.

The statement that the Statements of GAAP are aimed at achieving fair presentation is confirmed in the following accounting standards:

- In AC 100, Preface to Statements of GAAP, it is promulgated that the existence of a standard is an aid both to comparability and to fair presentation, but that compliance with a standard is no guarantee that fair presentation will be achieved in the financial statements. It is further also true that even though accounting standards are not conclusive as to fair presentation, they are nevertheless highly influential and persuasive in that respect (SAICA 1983:par7).
- In AC 000 it is stated that the application of the principal qualitative characteristics and appropriate accounting standards normally results in financial statements that convey what is generally understood as a true and fair view of, or as presenting fairly such information (SAICA 2004:par46).
- In AC 101, Presentation of Financial Statements, it is also stated that the appropriate application of the Statements of GAAP, with additional disclosure when necessary,

results virtually in all circumstances in financial statements that achieve a fair presentation (SAICA 1998:par11).

In addition to the above conclusion, namely that by complying with the Statements of GAAP, fair presentation is usually accomplished, it is elucidated by Everingham, Kleynhans & Posthumus (2003:9) that in order for information to be presented faithfully, financial statements should reflect economic substance and financial reality, not merely legal form. The substance of a transaction is determined by identifying all its aspects and implications and by giving greater weight to those likely to have commercial effect in practice. Where a transaction is only one in a connected series, the substance of the series of transactions should be viewed as a whole (Alexander & Britton 1993:351). Furthermore, according to the ASB (2001:11), it is necessary to identify whether the transaction has given rise to new assets or liabilities for the reporting entity and whether it has changed the existing assets or liabilities of an entity in order to determine the substance of a transaction.

The importance of recording transactions in accordance with their substance is also recognised within GAAP (Ekholm & Troberg 1998:119). For example, in AC 100 it is stated that transactions and other events should be accounted for and presented in accordance with their substance and financial reality and not merely with their legal form (Cilliers, Coetsee, Stegman, Van Schalkwyk, Wenson, Dempsey 2002:422).

However, in the opinion of Murphy (1997:Webpage), substance-over-form accounting was only designed to prevent abuse in large companies' financial statements. This is because abuse in small entities' financial statements can usually be viewed as blatant tax-evading fraud and no standard will prevent that. He concluded that transactions should be reported as they are.

Even so, the general view is that compliance with the Statements of GAAP will achieve fair presentation in the financial statements of enterprises. However, in AC 101 it is recognised that there may be rare instances where compliance may lead to a loss of fair presentation, consequently resulting in the necessary departure from the Statements of GAAP. When assessing whether a specific departure is necessary, consideration should be given to the following (Vorster, Koen *et al.* 2003:32):

- The objective of the requirement and why that objective is not achieved or is not relevant in the circumstances; and
- The way in which the circumstances of the enterprise differ from those of other enterprises which follow the requirement.

With regard to these deviations, legal opinion noted that non-compliance with a statement does not necessarily constitute a lack of fair presentation; and compliance with GAAP does not, on its own, constitute fair presentation. The wider views of "best accounting practice" will also be relevant (Pain & Blakemore 1997:12). This leads to the next question: Does the "best accounting practice" include differential reporting, for example the proposed LPFRS? In other words, will differential reporting still achieve fair presentation in the financial statements of close corporations and other small entities?

According to Coppin (1996:12), accounting standards are the main source of determining what constitutes fair presentation. If different standards apply to smaller entities, it could result in the disclosures provided by larger enterprises not being regarded as fair presentation, but exactly the same presentation to be considered fair presentation in smaller enterprises. This would mean that fair presentation is viewed not against a standard that is common to all enterprises, but against some arbitrary criterion which distinguishes between the sizes of enterprises.

In the opinion of Paterson (2001:96) there is an obvious legal difficulty with the principle of having differential reporting rules, because companies of all sizes are subject to the same statutory requirement to present financial statements that give a true and fair view. Close corporations are also subject to a statutory requirement to fairly present events in their financial statements. This leads to the question whether the true and fair view of two entities should be different simply because of their size. A discussion paper published in the UK on the subject advances reasons why this could be so, based mainly on the fact that large and small entities tend to have rather different users of their financial statements.

Notwithstanding the above, traditionalists argue that having two sets of rules brings accounting into disrepute and forces users to incur extra costs. The argument is that if the financial statements are supposed to give a true and fair view, how can one say that some entities have a different kind of true and fair view than others? It is postulated that this will damage both the credibility of accountants and the credibility of the financial statements (Walton 1998:2). In the opinion of Fisher (1994:23) the status of standards will suffer if it is suddenly decided that the financial statements of small entities can show a true and fair view when only a handful of standards are adhered to.

On the other hand, Walton (1998:2) posed a counter-argument by mentioning that these are very different kinds of entities and that their financial statements must reflect these differences, as must the users in their decision criteria. Differential reporting is simply reflecting the economic reality in regulation that protects the small enterprise from excessive and burdensome rules, while allowing the regulator to focus on the real problems of multinational reporting.

The above-mentioned two arguments are recaptured by Murphy (1998:64) who asserts that discussions about appropriate reporting for small entities tend to centre on the "big GAAP vs. little gaap" debate: one group of people argues that we need a separate set of accounting rules for smaller entities (little gaap); another group argues that there can only be one GAAP with a list of exemptions. The key difference between these two views is contained in the question whether small entities can be allowed to use different recognition and measurement rules from large companies and still achieve fair presentation. In other words, can close corporations and other smaller entities have a different level of fair presentation compared to public companies?

The empirical study investigated the opinion of the CFAs on this question, and the majority of respondents agreed that close corporations can have a different level of fair presentation. Accordingly, it can be concluded from these results that it is possible for close corporations and other small entities to have a different level of fair presentation in their financial statements compared to that of public companies.

In conclusion, it is the opinion of the so-called traditionalists that compliance with all of the requirements of the Statements of GAAP will result in fair presentation in the financial statements of close corporations and other small entities (Vorster, Koen *et al.* 2003:32). Nevertheless, there are counter-arguments that state that differential reporting standards will still achieve fair presentation in the financial statements of close corporations and other smaller entities. The basis of this argument is that it is believed that it is possible for close corporations and other smaller entities to have a different level of fair presentation compared to large public companies. This is also the opinion of the majority of CFAs in the Free State region.

Another objection raised against the differential reporting principle is the believed costs involved in maintaining two sets of accounting standards and the opinion that a list of exemptions will be more appropriate. In the next section the cost vs. benefit principle is analysed in order to determine if this objection has any merit.

2.7 Cost vs. Benefits

The general principle of the cost vs. benefit restraint is that the costs of producing information should not outweigh the likely benefits of providing it (Reid & Myddelton 1992:2). In this restriction, a "materiality threshold" is suggested as such that the benefits provided by the disclosure of information should exceed its cost (Smith 1996:11). Nevertheless, in the opinion of Joubert (1993:5) one should not exclude information from the reporting process which may be supplied cost-ineffectively over the short term, if it ensures maximum benefit over the long term.

The cost vs. benefit restraint is enlarged upon by Tweedie, as quoted by Parker & Nobes (1994:ix). He states that the legitimate aspirations of users of financial statements for information to enable them to assess both the effects of the interaction of a company with its trading environment and its financial strength at the end of that period, must be limited by a need to measure the costs of producing the information against the benefits resulting from its disclosure. In this regard, the presentation of financial information entails a trade-off involving commercial sensitivity, costs of production, relevance and reliability. This balance between benefit and cost as a pervasive constraint on relevant and reliable information rather than on qualitative characteristics is also identified in AC 000 (Cleminson & Rabin 2002:336).

On the aspect of the enforceability of the cost vs. benefit constraint, it is advocated by Alexander & Britton (1993:161) that standard-setters in particular, as well as the preparers and users of financial statements, should be aware of this restraint. There is, however, a number of inherent difficulties associated with the cost vs. benefit restraint that standard-setters should keep in mind, for example:

- The evaluation of benefits and costs is substantially a judgmental process, with costs that are not necessarily carried by those users who enjoy the benefits; benefits may also be enjoyed by users other than those for whom the information is prepared (Alexander & Britton 1993:161);
- The costs or benefits of any particular reporting requirement can vary from industry to industry or even from firm to firm (Lippitt & Oliver 1983:56);
- The benefits and costs of providing information differ in the case of different reporting entities, depending in part on the nature and number of the users of the financial statements and therefore on the way in which the financial statements are used (CICA 2001:Webpage); and
- The costs and benefits of financial statements used within a business or for other limited purposes differ from those of financial statements provided to external parties (Hepp & McRae 1982:53).

For the above-mentioned reasons, it is concluded by the ASB (1991:103) that it is difficult to apply a cost-benefit test in all cases.

In order to simplify the practical application of the cost-benefit restraint, Cleminson & Rabin (2002:336) explained the restraint in more simple terms with the statement that the benefits derived from GAAP application depend mostly on the number of financial statement users. Mersereau (2002:32) amplified this statement by expressing the opinion that the fewer the users of the financial statements of enterprises and the greater their ability to gain access to information additional to that provided in the financial statements, the smaller the benefits to be derived from information contained in financial statements.

The above-mentioned view is corroborated in section 2.4 where it was concluded that non-publicly accountable enterprises, like close corporations, typically have a narrower range of users of their financial statements compared to public companies. Furthermore, the users of non-public entities are generally known to the enterprise, often having an intimate knowledge of it, and thus may place less reliance on the financial statements for making investment decisions, compared to the users of financial statements of public companies. Most of the users of the financial statements of non-public entities also have the capability or the contractual right to obtain additional information from management, thereby reducing their reliance on the financial statements even further (CICA 2001:Webpage).

Walton (1998:2) also argued that economies of scale mean that the cost of accounting, and changes in accounting, are typically lower in large companies than small entities. The basis of this argument is the fact that for producing information to meet some standards in a small business, a greater proportion of available resources are used than is the case for a large business (Hepp & McRae 1982:53).

A further difficulty associated with the cost vs. benefit constraint is the identification of the costs involved which could be direct, indirect or opportunity costs. These costs are discussed in the following sections.

2.7.1 Direct costs

Direct costs include the cost of considering whether a particular standard is applicable to the entity, the cost of assembling the information, the cost of auditing the information (in the case of companies), and potentially the loss of commercial advantage arising from the increased disclosure (Wild & Carter 1995:80), because compliance with accounting standards may lead to the disclosure of strategic information to competitors (Williams & Tower 1998:264). Furthermore, those who could benefit from this information, often do not have to bear the costs, hence the pressure for more disclosure increases (Reid & Myddelton 1992:2).

The increase in disclosure requirements is not the only cause for concern. The recognition and measurement requirements have also become more complicated over the years. As standards became more comprehensive and thus inevitably more detailed, the costs of compliance therewith also increased (ASB 1994:11). Small enterprises do not usually have the internal resources required to prepare financial statements, thus they often have to use the services of an external professional. In addition, since they have a limited number of users, it costs them more per user to apply the Statements of GAAP, compared with listed companies (Prinsloo 2000:1).

These direct costs are not the only costs to consider. There is also an opportunity cost associated with the preparation of financial statements of close corporations and other small entities. These costs are discussed in the next section.

2.7.2 Opportunity costs

Opportunity costs entail the time and money spent on developing the information required according to accounting standards that are consequently not available to develop other information that may be more useful to business and the users of their financial statements (Hepp & McRae 1982:53). Accordingly, the scope of funds left for producing more meaningful, useful and very often essential information is greatly reduced (Marriott 1997:33).

To expand on the concept of opportunity costs, Upchurch, as quoted by Qua-Enoo (2002:126), postulated that information is a resource and, like all resources, has a cost attached to it, which could be either explicit or implicit. The explicit cost of information is exemplified by expenditures such as payments to an outside consultant to undertake a market survey, or the acquisition of decision-supporting software. High as such costs may be, the implicit cost of information may be even higher. Management must spend time collecting, collating and interpreting information. It therefore follows that the more detailed the information that is sought, the greater the cost would be.

It can be concluded from the above discussions that the cost of compliance with the Statements of GAAP is high. According to Hattingh (2001:23), the payback for a listed company is the reduction in the cost of capital and savings if a cross-border listing is obtained. On the other hand, he concluded that there is no benefit to be gained from adopting Statements of GAAP in respect of a small owner-managed business. Compliance with these rules may even result in financial statements being more complex and costly than necessary (Lippitt & Oliver 1983:52).

The problem with applying current accounting standards to smaller entities, according to Koppeschaar (2002:2), stems partly from their nature and partly from the weight and complexity of the accounting standards. Often the cost of consideration and compliance outweighs the usefulness or relevance of the disclosed information. However, in the opinion of Holgate & Smith (1995:93), some of the standards only apply to listed or larger companies. This is because accounting standards need not be applied to immaterial items and many smaller entities are unlikely to undertake regularly, if at all, transactions which may need reference to a complicated accounting standard. It is therefore possible that the problem could be over-emphasised, because most of the standards may not be applicable on small entities.

Nevertheless, international studies, for example studies undertaken by Nair & Rittenberg (1983:96) and Carsberg *et al.*, as quoted by Williams & Tower (1998:264), have generally revealed that small business managers perceive the cost of complying with accounting standards to be greater than the benefits achieved. Other studies have also stressed that compliance with accounting regulation represents a substantial cost for small companies which is not justified by the benefits that accrued from the information published in annual accounts (McAleese 2001:18). It is therefore concluded by the IASB (2002:4) that the cost of applying financial reporting standards falls disproportionately on small entities.

In this regard, the members of close corporations and CFAs were asked in the empirical research questionnaire if the costs of the financial statements, according to them, exceed the benefits they receive from the financial statements. According to 70% of the members that responded, the costs of their financial statements exceed the benefits they receive from the financial statements. Only 56% of the CFAs that responded, replied that the costs of the financial statements exceed the benefits. The surprisingly small majority may be ascribed to the fact that it is no longer a requirement to prepare the financial statements of close corporations in accordance with the Statements of GAAP, resulting in a reduction in the cost of preparation. Nevertheless, the majority of the members and CFAs were of the opinion that the costs of the financial statements exceed the benefit.

As a suggested solution to this paradox of cost and need, it is the opinion of Burton & Hillison (1979:21) that it could be alleviated by requiring only those disclosures which are consistent with the needs of users. He suggested that differential reporting by means of making selected disclosures optional, would greatly reduce costs for small and/or closely held firms.

On this point, Holmes and Lambert, as quoted by Kent & Munro (1999:361), stated that accounting practitioners supported the introduction of differential reporting on the basis that differential reporting would reduce the cost of preparing financial reports for their clients. The cost reduction could, however, be neutralised by additional costs incurred by the presentation of non-GAAP financial statements. This is because it is expected that entities that supply non-GAAP financial statements will incur indirect costs that those entities who supply GAAP financial statements would not incur. These costs are discussed in the following section.

2.7.3 Indirect costs

Indirect costs result from the increased information asymmetry and decreased reliability of financial statements with the presentation of non-GAAP reports (Kent & Munro 1999:363), for example:

- The presentation of non-GAAP financial reports to loan officers for loan evaluation purposes can, according to Mosso *et al.*, as quoted by Kent & Munro (1999:363), result in an increase in the cost of capital for these borrowers and they may request additional information when financial reports have not been prepared applying GAAP; also
- Lenders may demand a higher interest rate or other compensation when extending loans to entities that prepare "lower quality" financial statements. This additional interest might outweigh the cost of preparing the information required by IFRS or South African Statements of GAAP (IASB 2002:2).

In the empirical research study, the personnel of banks were asked whether non-compliance with the Statements of GAAP in the financial statements of close corporations would influence their decision regarding the provision of loan facilities to close corporations, and if so, to specify. According to 71% of the respondents, non-compliance would influence their decision on the advancement of loan facilities to close corporations. They specified that the integrity of the statements would be questioned. This confirms the exposure of close corporations to indirect costs if non-GAAP financial statements are presented to banks.

The personnel of banks were further asked if the presentation of non-GAAP financial statements would influence the interest rates or other bank charges when providing loan or overdraft facilities to close corporations and if so, to specify. According to 57% of the respondents, interest rates and/or bank charges would not be influenced by the presentation of non-GAAP financial statements. The remaining 43% specified that interest rates and bank charges are risk-related, thereby implying that the risk for the bank would increase due to the submission of non-GAAP financial statements. These results confirmed the exposure of close corporations to indirect costs if non-GAAP financial statements are presented to banks.

In addition to the above, it is believed that there will also be cost to the users. This is from the perspective that the understandability requirement is identified as the first qualitative characteristic of financial statements (IASB 2002:4). It is said that users are ill served by information that is ambiguous or confusing or that cannot be assessed. Nevertheless, it is advocated by the IASB (2002:2) that users are certainly ill served if preparers abandon high-quality standards of financial reporting and adopt alternatives that lack the comprehensive approach, transparency, and comparability provided by IFRS and similar sets of accounting standards.

It can be concluded from the above-mentioned discussions that indirect costs may be incurred if the financial statements of close corporations and other small entities are not compiled by using the Statements of GAAP. It is even the opinion of Gibson, as quoted by Kent & Munro (1999:361), that the benefits associated with the production of financial reports that conform to all reporting requirements (GAAP) can exceed the apparent cost reductions associated with differential reporting.

Another argument in favour of the use of the full requirements of the Statements of GAAP lies in the limited liability concept. In 1975, it was recommended in the UK Corporate Report that the company would have to bear the cost of supplying additional information to all user groups. According to Nobes (1992:121), this is justified by the argument that companies have the benefit of limited liability and have an important effect on the economy and society, and therefore they should act responsibly. This includes the supplying of information.

This opinion that compliance with accounting standards should be regarded as part of the cost to be paid for the benefit of limited liability, is expressed by a number of authors (Holgate & Smith 1995:93). It can also be made applicable to close corporations. In this regard, the CFAs were asked in the empirical research questionnaire whether they agree that compliance with the Statements of GAAP is a price to be paid for limited liability by close corporations. 68.75% of the respondents agreed with this view.

Nevertheless, according to Lippitt & Oliver (1983:56), all information disclosure requirements should be evaluated from a cost-benefit perspective. Information should only be included if the benefits are considered to outweigh the costs of providing the information (Everingham, Kleynhans & Posthumus 2003:9).

Even so, it is the opinion of Wilson (1995:93) that the question is not whether standards impose a burden on small entities, but whether they are of any value. Accordingly, the real issue involved is whether existing standards provide small businesses with a reporting framework that generates information which is useful, relevant and reliable for decision-making purposes. The usefulness of the current form of financial statements of close corporations for the users is further analysed in chapter 5 where the results of the empirical research questionnaire are presented.

2.7.4 To summarize

Close corporations and privately-owned companies experience substantial costs due to financial reporting requirements, and owner-managers and financial institutions are usually the sole information users (Chung & Narasimhan 2001:120). According to Hattingh (2001:35), the consensus among practitioners is that there are no benefits to be derived by close corporations and private companies from complying with the onerous requirements of Statements of GAAP. The cost issue is thus very real from the perspective of the client, but while the cost issue is always important, it is not the real crux of the matter. The satisfaction of the needs of financial statement users is the real question and this leads to the central issue discussed in this section, namely "Should disclosure and measurement requirements prescribed by GAAP be applied to all entities or should application be made on specific and explicit criteria?" (Burton & Hillison 1979:21).

The above-mentioned question on the applicability of disclosure and measurement requirements contained in the Statements of GAAP with regard to close corporations and other small entities forms the central argument of the debate on differential reporting. The differential reporting concept is further elaborated in the next chapter.

2.8 Conclusion

In this chapter the broad aspects of financial reporting with its applicability to close corporations were discussed. The objective of financial statements, their users and the requirements of fair presentation and cost vs. benefits were analysed to highlight the differences between public companies and close corporations/other small entities.

The empirical study revealed that even though the majority of users find the financial statements of close corporations useful, some members replied that they do not use the financial statements at all. This is contradictory to the objective of financial statements, namely to provide the users of financial statements with useful information, despite the size of the entity.

The main users of the financial statements of close corporations are identified as the members, bankers and SARS. These users mainly use the financial statements as a tool for raising loan finance and supporting tax calculations, and to a lesser degree as a source of management information for decision-making purposes. Accordingly, the financial statements of close corporations are used only for a limited purpose and not a general purpose as in the case of public companies. This supports the decision of SAICA to develop LPFRS for small entities.

Another fact supporting the development of differential reporting for close corporations and other small entities is the majority decision of members (70%) and CFAs (56%) that the cost of compiling the financial statements of close corporations exceeds the benefits derived from it. The majority of CFAs (81%) also agreed that close corporations could have a different level of fair presentation in their financial statements compared to public companies.

The empirical study furthermore revealed that only 40% of the members of close corporations, but 81% of the CFAs, agreed that close corporations should have a separate set of accounting standards. It was also found that the majority (75%) of the respondents agreed that these standards should be presented as a separate set accounting standards and not as differential reporting listed in each statement.

The need for differential reporting standards for close corporations and other small entities was therefore identified in this chapter. The difficulties associated with such a development are, discussed in the next chapter.

CHAPTER 3

DEVELOPMENTS IN FINANCIAL REPORTING FOR SMALL ENTITIES

3.1 Introduction

Differential reporting resulted from the perceived accounting standards overload experienced by small entities, including close corporations. The believed accounting standards overload stems from the differences between the accounting needs of small entities and large, listed companies. These differences mostly revolve around the nature of the users of the financial statements of the different type of entities and their different information needs. These differences were discussed in some detail in the previous chapter and differential reporting was proposed as a means of providing relief for small entities from the onerous requirements of the Statements of GAAP. It is further the belief that differential reporting will supply more useful information to the users of the financial statements of these small entities.

Even though differential reporting is a relatively new topic in South Africa (SA), it has been discussed since as early as 1974 in the United States (US). Other countries, for instance the United Kingdom (UK), Australia, Canada and New Zealand, also introduced some type of differential reporting recently.

However, the development of differential reporting revealed that the concept has various difficulties associated with it, including the following:

- the entities that may qualify for relief must be identified; and
- an appropriate accounting practice should be chosen.

The difficulties experienced in the development process are discussed in detail in this chapter, together with the numerous opinions raised and research evidence gathered on the differential reporting concept and current differential reporting models. The international and national historical background to the development of differential reporting is also provided.

3.2 International and national developments

Differential reporting is a relevantly new concept in SA, but it will be seen in this section that it has a long history in international accounting. Various countries have debated on the concept and as a result, implemented some type of differential reporting.

In the US, the debate on financial reporting standards for small entities dates back to July 1974, when the American Institute Committee of Certified Public Accountants (CPA) was appointed to study the issues surrounding the question of the extent of required financial statement disclosure for closely held corporations. This led to the issuance of a discussion paper on "The Application of Generally Accepted Accounting Principles to Smaller and/or Closely Held Businesses", in March 1975 (Falk, Gobdel & Naus 1976:85).

Also in 1975, the American Institute of Certified Public Accountants (AICPA) formed a committee, the Committee on Generally Accepted Accounting Principles for Smaller and/or Closely Held Businesses, to study some of the pertinent aspects of accounting and reporting for small businesses, particularly the applicability of GAAP (Burton & Hillison 1979:17). This resulted in the issue of the "Report of the Committee on Generally Accepted Accounting Principles for Smaller and/or Closely Held Businesses" by the AICPA in 1976. The committee concluded that the size or ownership of an entity should not result in the application of different measurement standards (IASB 2001:Webpage).

Nevertheless, in 1978, the Financial Accounting Standards Board (FASB) suspended the requirement to disclose earnings per share and segment information for companies whose securities are not publicly traded. Accordingly, the FASB officially recognized that certain types of required financial information may be disclosed outside financial statements and was making good progress in its endeavour to distinguish between disclosures that should be required of all enterprises and disclosures that should be required of only certain designated types of enterprises (Hepp & McRae 1982:58).

In order to initiate further study, the AICPA formed a second committee, the Special Committee on Small and Medium-size Firms, also in 1978, with the objective to study the viability and prospects of such firms. Their report of October 1980 agreed that too much disclosure is required of smaller companies, and concluded as well that some of the measurement standards of GAAP are not useful or economically justified in small, owner-managed companies (Lippitt & Oliver 1983:53). The report also identified accounting standards overload as one of the many problems confronting such firms and recommended that the AICPA appoint a special committee to study alternate means of providing additional relief from accounting standards that are not cost-effective for small businesses (Hepp & McRae 1982:53).

In response to the recommendation in the 1980 report, the AICPA board of directors established a special committee on accounting standards overload in the spring of 1981. After further study, the special committee issued a discussion paper, "Tentative Conclusions and Recommendations of the Special Committee on Accounting Standards Overload", on 23 December 1981, for public comment before 31 May 1982. This discussion paper described its deliberations and the evidence it considered, and set forth its tentative conclusions and recommendations (Hepp & McRae 1982:53). The report recommended that an "adjusted" income tax method be used by small, private businesses (Lippitt & Oliver 1983:53).

At the same time, Professor Naude, a member of the Standing Advisory Committee on Company Law (SAC) in SA, prepared and published a memorandum entitled "The need for a new legal form for small businesses", outlining the problem and its solution. Professor Naude suggested that the answer did not lie in an amendment of the Companies Act, but in the establishment of a new legal form for small businesses, incorporated in a separate

Act. The SAC subsequently accepted the suggestions put forward in this memorandum and instructed Professor Naude to prepare a draft bill. This draft bill was published towards the end of 1983 and became the Close Corporations Act No. 69 of 1984 in its present form (Allan, Delport, Henning, Viljoen 1984:1).

In 1985 a research study carried out in the UK by Professor Carsberg *et al.,* as quoted by Davies, Paterson & Wilson (1989:11), on small company financial reporting, adversely concluded that the burden imposed by accounting standards and other reporting requirements do not seem to be a matter for primary concern among people in small companies. In attempting to explain this finding, the report suggested that small company managers may perhaps have little awareness of what is involved in complying with standards, because they leave this aspect of their accounting to their professional advisers.

Continuing in the UK, the Accounting Standards Board (ASB) commissioned a working party in October 1986, to investigate the application of accounting standards to small companies. The findings of the working party were also that there is no evidence to suggest that, in general, small companies find compliance with accounting standards unduly burdensome, given that they have to prepare financial statements that give a true and fair view (Davies, Paterson & Wilson 1989:11).

Shifting to Australia, also in October 1986, the Schedule Seven reporting requirements of the Australian Companies Act of 1981 were restructured, and in the course of this restructuring the schedule was effectively tiered, with different disclosure requirements for different types of companies. During 1988/89 the differential reporting debate in Australia gathered momentum, resulting in the release of Exposure Draft 48 – Proposed Statement of Differential Reporting - and subsequent policy statements by the Australian Accounting Research Foundation (AARF) (Holmes, Kent & Downey 1991:125).

However, the process of developing differential reporting only commenced in earnest in June 1992. After 30 June 1992, the standards of the Australian Accounting Standards Board (AASB) applied only to companies which were "reporting entities" (Campbell 1996:22). The "reporting enterprise" concept is defined by the Australian Research Foundation in its "Statement of Accounting Concepts", as an entity in respect of which it is reasonable to expect the existence of users dependent on general purpose financial reports for information which will be useful to them for making and evaluating decisions about the allocation of scarce resources (Prinsloo 2000:3).

The Foundation also issued a "Statement on the Objectives of General Purpose Financial Reporting". This framework defines the obligation to provide general purpose financial statements when there are external users who depend on the financial statements of the enterprise to make decisions about the allocation of resources, i.e. users who cannot command the preparation of financial information to satisfy their needs. Enterprises, which are not reporting enterprises as defined, may choose to prepare financial statements for specific purposes in accordance with an appropriate disclosed basis of accounting (Prinsloo 2000:3).

New Zealand soon followed with the publication of the "Framework for Differential Reporting" in 1994 by the Institute of Chartered Accountants of New Zealand. This document, which was updated in 1997, included several full or partial exemptions from recognition, measurement, or disclosure requirements of New Zealand accounting standards (IASB 2001:Webpage).

Moving back to the UK, the ASB formally introduced differential reporting in November 1997 with the issuance of its Financial Reporting Standard for Smaller Entities (FRSSE). This was the end product of a rather unusual process which involved the UK professional bodies constituting a working party to issue a discussion paper, which subsequently served as the basis for FRSSE. The discussion paper was issued in draft form before being finalised. This was also the case with the FRSSE. The whole idea was given several periods of exposure, and the process took about four years from start to finish (Walton 1998:3).

The development process started when the working party was set up by the ASB. They published a consultative document, "Exemptions from Standards on Grounds of Size or Public Interest", in November 1994, now commonly referred to as "Big GAAP/little gaap" (Holgate & Smith 1995:93). In December 1995, another consultation document was published, the results of which have been incorporated into the Exposure Draft (ED) of the FRSSE, published in December 1996 (Jackson 1997:75). In 1997 the UK ASB first issued the "FRSSE" (IASB 2001:Webpage).

Shifting to Scotland, the Institute of Chartered Accountants of Scotland (ICAS) published the Consultation Paper "Breaking the Code...A Better Reporting Framework for Small Companies" in October 1998. This contained new and radical financial reporting proposals for small companies based on an analysis of the information needs of the users of small company accounts (ICAS & ICAEW Small Companies Working Party 1999:1).

In the same year, the South African process of the development of differential reporting commenced, with a meeting of a working group consisting of a number of parties interested in the reporting practices of small enterprises. These parties included representatives from small and large accounting practices, SACOB, academics, the Revenue authorities and other accounting institutes (Heymans 2000:31). Thereafter, attempts have been made to revise the reporting requirements of small business enterprises, resulting in discussion paper (DP) 16, "Limited Purpose Financial Statements" (LPFS), published in May 2000 (Cleminson & Rabin 2002:336).

DP 16 advocated the maintenance of the recognition and measurement standards in Statements of GAAP for LPFS, but confirmed that there was a real need to reduce the burden of excessive disclosures. DP 16 was, however, not accepted as the ideal solution. The reduction of specific disclosures was not substantial enough to have a significant effect on the compliance with GAAP, therefore the development process continued (Cleminson & Rabin 2002:336).

In April 2001 SAICA published "The Proposal of SAICA with regards to Legal Backing for and the Monitoring of Compliance with Accounting Standards", which further acknowledged that it is neither reasonable nor practical to require small companies to comply with current accounting standards. It was proposed by SAICA that the Companies Act No. 61 of 1973 be amended to provide for small companies to prepare financial statements in conformity with limited purpose financial reporting standards (LPFRS) (Koppeschaar 2002:3).

To assist in the development process, the proposed Financial Reporting Act, which will be issued at the same time as the above-mentioned proposed Companies Act Amendments, provided for the establishment of a Financial Reporting Council responsible for laying down limited purpose financial reporting standards. It also provided for the Financial Reporting Standards Council to appoint a subcommittee to develop the standards for approval by the Council (Koppeschaar 2002:3).

The above-mentioned subcommittee, the Limited Purpose Financial Reporting Committee of SAICA, prepared the Exposure Draft 163, "Framework for the preparation and presentation of limited purpose financial statements", published in June 2003. ED163 provides guidance for the development of LPFRS (SAICA 2003:13). However, in a meeting held on 14 September 2004 by the Limited Purpose Financial Reporting Committee of SAICA, it was agreed that the Committee should not develop ED163 further, as the IASB had commenced on a project to develop financial reporting standards for small and medium-sized entities, which could be adopted in SA (SAICA 2004:3).

In Canada, the development process also started in 1998 when the Canadian Accounting Standards Board (AcSB) commissioned a Research Report to examine how the information needs of the users of the financial statements of small business enterprises might be met more effectively and the degree to which reporting in accordance with GAAP could be modified to meet those needs. This Research Report, "Financial Reporting by Small Business Enterprises," was published in May 1999 and proposed that a differential reporting principle be established within Canadian GAAP (CICA 2001:Webpage).

The Canadian AcSB also established the Small Business Enterprises Advisory Committee, recently renamed the Differential Reporting Advisory Committee, in May 2000, as a standing committee to provide input to the standard-setting process from a non-public enterprise perspective and to consider further the need for differential reporting and the ways to make the principle operational. The advisory committee supported introducing differential reporting into Canadian GAAP and made a number of practical recommendations to the AcSB (Mersereau 2002:31).

This led to the issuance of an exposure draft (ED), "Differential Reporting" by the Canadian AcSB in July 2001, according to which a differential reporting principle was introduced into Canadian GAAP on the basis of cost/benefit considerations. It was proposed that the AcSB should assess the cost/benefit trade-off by reference to the profiles and needs of users of financial statements (Cairns 2001:100). The ED further proposed recognition, measurement, and disclosure exemptions in six areas of Canadian accounting standards (IASB 2002:1).

The ED attracted more than 120 letters and, although the proposal to allow differential measurement options generated some controversy, in general, the comments in the mentioned letters strongly supported the introduction of differential reporting (Mersereau 2002:31). This resulted in the approval of a new Handbook Section 1300, "Differential Reporting" and a few related amendments to certain Handbook Sections by the Canadian AcSB in December 2001, which set out the differential reporting options available (SAICA 2002:3). These differential reporting requirements formed part of Canadian GAAP and was effective from 1 January 2002. Earlier adoption was not permitted (compare CICA Accounting standards Board 2001:2). In February 2002, CICA issued an accounting standard for differential reporting that adjusted recognition and measurement criteria (Koppeschaar 2002:3).

Shifting to international grounds, Tweedie, as quoted by the IASB (2001:10), wrote to members of the Standards Advisory Council (SAC) in August 2001 to solicit their views on whether the IASB should also initiate a project on financial reporting by SMEs, and if so, what form that project should take. In addition, SAC members were requested to prioritise such a project.

The most common comment was that IASB should work toward producing more usable standards for all constituents (IASB 2001:10). In this regard, an Intergovernmental Working Group of Experts on International Standards of Accounting and Reporting, operating under the auspices of the United Nations Conference on Trade and Development, was formed (IASB 2001:Webpage).

The suggestion made by the Working Group was that an SME framework should be introduced. This would be based on compatibility with IAS, but would provide a nested set of rules whereby, as the business grew, it would progress up a ladder of accounting evolution, starting with cash-basis accounts and moving then to simple accruals and ultimately to full IAS. The system recognised that reducing disclosure requirements from IAS is not a sufficient solution in a developing economy and that the transition from no accounts to full IAS must proceed as smooth as possible, with no sudden steps being taken (United Nations Trade and Development Board 2000:20).

The Intergovernmental Working Group of Experts on International Standards of Accounting and Reporting (ISAR) continued the development process and decided at its sixteenth session to devote its seventeenth session to examining the accounting needs of SMEs (United Nations Trade and Development Board 2000:1). It was decided that the seventeenth session of the Intergovernmental Working Group of Experts on ISAR, which was held in Geneva from 3 to 5 July 2000, should deliberate on the accounting needs of SMEs (United Nations Trade and Development Board 2001:1).

At this session, the Working Group recommended that *ad hoc* expert consultations be held with a view to formulating recommendations for a financial accounting and reporting framework appropriate for SMEs. To that end, an *ad hoc* consultative group consisting of 23 experts from a wide cross-section of countries and of organizations such as the IASB, the International Federation of Accountants, the World Bank, the Asian Development Bank and the European Commission, as well as various professional accounting associations, government standard-setters, academia, practitioners and others, was formed. The *ad hoc* consultative group further decided that it was necessary to specify a framework which covered all entities likely to prepare annual financial reports (United Nations Trade and Development Board 2001:3).

After a period of consultation, the draft recommendation was circulated to all members of ISAR. They debated on it at the 18th session, which was held at the Palais des Nations, Geneva, from 10 to 12 September 2001 (compare IASB 2001:Webpage). As a result of these debates, the *ad hoc* consultative group decided that the approach which would best recognize the widely different nature of SMEs and their access to accounting expertise, would involve a three-tier accounting framework, including two tiers dedicated to SMEs (United Nations Trade and Development Board 2001:4). These three tiers are discussed in more detail in the next chapter.

In response to the recommendations received, the IASB launched a project to develop accounting standards suitable for SMEs during the second half of 2003 and in early 2004. This project resulted in the issuance of the Discussion Paper "Preliminary views on Accounting Standards for Small and Medium-sized Entities" in June 2004 (IASB 2004:11). The purpose of this Discussion Paper was to invite comments on the preliminary views of the IASB on specific issues, including the following (IASB 2004:1):

- Should the IASB develop special financial reporting standards for SMEs?
- What should be the objectives of a set of financial reporting standards for SMEs?
- For which entities would IASB Standards for SMEs be intended?

- If IASB Standards for SMEs do not address a particular accounting recognition or measurement issue confronting an entity, how should that entity resolve the issue?
- May an entity using IASB Standards for SMEs elect to follow a treatment permitted in an IFRS that differs from the treatment in the related IASB Standard for SMEs?
- How should the Board approach the development of IASB Standards for SMEs? To what extent should the foundation of SME standards be the concepts and principles and related mandatory guidance in IFRSs?
- If IASB Standards for SMEs are built on the concepts and principles and related mandatory guidance in full IFRSs, what should be the basis for modifying those concepts and principles for SMEs?
- In what format should IASB Standards for SMEs be published?

The development of the above-mentioned Accounting Standards for SMEs is still underway.

To summarize, the above layout of the international development process of differential reporting gave a glimpse of a wide variety of different opinions and pending questions on differential reporting. These opinions do not only differ from one country to another country, but also from one individual to another. In the next section, the different opinions are discussed in more detail and a few of the difficulties that emanated from the development of the differential reporting principle are discussed.

3.3 Difficulties experienced in the developing process

As identified in previous chapters, there are various obstacles deterring the development of financial reporting standards for close corporations and other smaller entities. These include standardising the financial reporting requirements of close corporations and other smaller entities to ensure fair presentation, while taking into account the needs of these entities and the users of their financial statements. Furthermore, in the development of comprehensive differential reporting standards, for example LPFRS and FRSSE, two major difficulties were experienced. The first problem experienced with regard to the implementation of differential reporting is to identify small entities and the second problem pertains to the determination of an appropriate accounting practice for these entities (Koppeschaar 2002:2). These difficulties are examined in detail in the paragraphs that follow.

3.3.1 Identifying small entities

In order to identify small entities, it is necessary to establish a sensible definition of a small entity in order to distinguish small entities from large entities for financial reporting purposes (Koppeschaar 2002:3). Unfortunately there is no generally accepted definition of what constitutes a small entity (John & Healeas 2000:11) and furthermore, according to Koppeschaar (2002:3), a number of factors can be considered in distinguishing small entities. These different factors are analysed in this section.

One of the factors identified was by the Bolton Committee in 1971, who took the view that it depends upon the industry sector in question. For instance, what is perceived as small in manufacturing would be considered to be quite large in the construction industry. Furthermore, the Committee felt that it was impossible to have a single objective measure of size that could be applied equally to all businesses. Hence, they suggested the use of different criteria for businesses within different industrial sectors, as shown below (John & Healeas 2000:11).

Table 1 : Bolton's definition of a small firm
(John & Healeas 2000:11)

Sector	Definition
Manufacturing	200 employees or fewer
Construction, mining and quarrying	25 employees or fewer
Retailing and miscellaneous services	Turnover of £50,000 or less
Motor trades	Turnover of £100,000 or less
Wholesale trades	Turnover of £200,000 or less
Road transport	Five vehicles or fewer
Catering	All excluding multiples and brewery-managed houses

Another opinion is that of Wynarczyk *et al.*, cited in Storey, and quoted by John & Healeas (2000:12), who contend that small firms are characterised by a need to innovate, the likelihood of passing through a number of phases in their development, and high levels of uncertainty. They argue that there are three facets to this uncertainty:

- Firstly, small firms cannot influence prices;
- Secondly, they have a relatively small number of customers and products; and
- Thirdly, the owners, unlike many directors in quoted companies, are not necessarily driven by the need to maximise profits.

Various factors to determine a small entity for the purposes of differential reporting were also identified in an Irish research project, namely turnover, total assets, number of employees, ownership structure, users, lack of internal control, complexity of the entity and personal management style. Even though these factors relate to characteristics of small entities, which do have distinct characteristics e.g. uncomplicated accounting systems, a lack of a proper segregation of duties and limited income sources, these characteristics cannot be used to identify small entities, because they are too subjective and cannot be measured objectively (SAICA 2002:3).

The Australian Wiltshire Committee as quoted by McCahey (1987:58), used the following definition to identify a small business:

"a business in which one or two persons are required to make all the critical management decisions: finance, accounting, personnel, purchasing, processing or servicing, marketing, selling, without the aid of internal specialists and with specific knowledge in only one or two functional areas".

The managers should be informed enough to make all the critical decisions. Their information needs are thus entirely different from those of large companies with a number of specialists making decisions in specified areas of business. However, this definition is too vague to be applied in practice.

Another view is that of the IASB (2002:2) which contends that the focus in identifying small entities has usually been on entities that are "not big" and "not public", because a more precise definition has proved very difficult to develop. However, according to Walton (1992:49), the disadvantage of the qualitative approach is that it is using size as a surrogate for any test of the user base of an entity. He concluded that size is not a justification for differential reporting in itself and thus makes the pursuit of differential reporting more questionable, even though the size measures may be an effective operational indicator.

Further inherent difficulties associated with using qualitative characteristics as a method of differentiation, are the following (Heymans 2000:31):

- Firstly, size is a moving target and not a good measure for differentiation; and
- Secondly, the introduction of differential rules result in the establishment of two accounting systems which produce different answers.

Serving as evidence of the above opinions, current accounting practices worldwide in which differential reporting is determined based on the size of an entity, have been widely criticised. Critics feel that there is very little or no conceptual justification for differential reporting to be governed by the size of an entity and that the criteria should be based on the composition of the membership and management of an entity (SAICA 2002:7).

This conclusion, namely that the distinguishing criteria should be based on the composition of the membership and management of an entity, is supported by arguments that the most important difference between a small business and a listed public company lies in the nature of its ownership. The small business is characterised by the entrepreneur or family investing their own capital and running the business, while a listed company, in stark contrast, is virtually always run by professional managers acting on behalf of institutional investors who own the majority of shares (John & Healeas 2000:11). Accordingly, it is concluded by Koppeschaar (2002:3) that the key consideration in defining a small entity lies not in size or complexity, but in the relationship between owners and managers, since the information needs of owner-managers are entirely different from those of external users.

This difference in the relationship between owners and managers of large vs. small entities is also mentioned by the Bolton Committee, as quoted by McCahey (1987:58). They outlined the following features as typical of small firms:

- Firstly, in economic terms, a small firm is one that has a relatively small share of the market;
- Secondly, an essential characteristic of a small firm is that it is managed by its owners or part-owners in a personalised way, and not by means of a formalised management structure; and
- Thirdly, it is also independent in the sense that it does not form part of a larger enterprise and therefore the owner-managers should be free from outside control in making major decisions.

As seen from the above opinions, some favour qualitative characteristics, such as public accountability, over quantitative ones, such as size tests, to determine whether an entity should be permitted to use the differential reporting requirements. Qualitative characteristics have the advantage of being easier to implement across international boundaries, and can always be supplemented by local regulatory guidance (IASB 2002:2). On the other hand, the differentiation method is rejected by those who believe that it would be difficult to define an owner-managed company. However, according to Jackson (1997:75) this would not be a problem in the majority of cases, because the auditors of the company would usually be in a position to assess this from their accumulated knowledge of the company. The onus could further be placed on the company to demonstrate that it is owner-managed, and in most cases this would be quite simple.

Another opinion expressed by Garbutt (1999:29) is that the big vs. small debate is not the problem, but it is simply our perception arising from the frustration of applying the Statements of GAAP to enterprises that clearly do not require such extensive disclosure. According to him, size is not the issue, but the ability of the user to demand and obtain information.

This opinion is supported by SAICA (2002:3), which stated that in order to identify a small entity, one should refer to the users of the financial statements of small entities. As mentioned in section 2.4, the main users of the financial statements of small entities are to a large extent financial institutions, SARS and members/shareholders, who usually also manage the affairs of the entities. Accordingly, in theory these financial statements are used for limited purposes in contrast to the financial statements of a publicly listed company, which are used for general purposes. Even so, for some the limited purpose of the financial statements of a small entity does not serve as a benchmark to distinguish between large and small entities. This is because it is not a practical consideration due to subjectivity, even though it is widely acknowledged.

As a proposed solution to the problem of identifying small entities, SAICA (2002:3) are of the opinion that other objective criteria, which can either be qualitative, quantitative or a combination thereof, should be followed which in essence relate to the limited purpose of the financial statements of small entities. The criterion used to identify small entities should make it possible to distinguish the needs of the users of the financial statements of a small entity from those of other enterprises in order to better respond to these needs at the lowest cost.

In brief the above-mentioned opinions indicate that it is not an easy task to identify small entities for differential reporting purposes. Nevertheless, it can be concluded that qualitative distinctive criteria such as owner-management could be used to distinguish a small enterprise from a large enterprise, because size is clearly not an indicator of the different needs of users of either general purpose or limited purpose financial statements. As further refinement of the usage of qualitative measures as distinguishing method, SAICA (2002:7) provided the condition that all owners should consent to differential reporting and that all users should have the right to request further information.

The above-mentioned viewpoint could assist one in identifying small entities for differential reporting purposes. The second difficulty experienced in the development process of differential reporting comprises the debate on the reporting requirements of the identified small entities. There are three distinct accounting issues, namely those of recognition, measurement and disclosure. The problem is summarised by Koppeschaar (2002:3) with the statement that the question is whether only the disclosure burden of existing standards should be relaxed, or if alternative standards of recognition and measurement that better achieve the objectives of financial reporting for small entities should be developed. This problem is discussed in the following section.

3.3.2 Accounting issues

In the opinion of Davies, Paterson & Wilson (1989:11), owners of small entities have complained about the cost and inconvenience of applying accounting requirements which were designed for large public companies as a result of the increasing number of accounting standards. Some are of the opinion that accounting standards should apply equally to all financial statements which purport to present a true and fair view. Others believe that small entities should be exempted from the requirements of certain standards which are unduly burdensome, with the exemptions either listed in each statement or included in a separate accounting standard for smaller entities. Then there is yet a further contention that small entities should have a completely different set of accounting standards. From the above it is clear that different views on the accounting requirements of small entities exist, ranging from no exemption at all to a completely different set of accounting standards.

Those who believe that accounting standards should apply equally to all financial statements which purport to present a true and fair view, the so-called traditionalists, believe that a consistent and uniform set of reporting standards is necessary to allow for comparison and standardisation across different entities. They argue that a two-tier accounting system is confusing and inappropriate and would effectively reverse the harmonisation process, which has occupied centre stage in the last decade. Financial statements should, according to this group, be prepared by using accounting standards that are consistent and uniform over time and across entities (Koppeschaar 2002:3).

The main argument against differential reporting is that if accounting rules are not held to apply universally, the users of financial statements will lose confidence in them. This is, however, largely a matter of opinion and is based on the assumption that users are too set in their ways to understand two different bases for financial statement preparation, and that the users of the statements of multi-national companies are the same as the users of the statements of small entities, with the same information needs (Walton 1992:47). It was concluded from the previous chapter that not all users have the same needs and accordingly do not all require the same amount or type of disclosure (Burton & Hillison 1979:20).

Another argument raised against differential reporting is that the full set of financial statements is a big price to pay for limited liability. This viewpoint merits some support, but it is not clear who is protected by the provision of financial statements. In a normal small business, the annual financial statements reach the registry of companies at least six months (and often 10 or 12 months) after the date on the balance sheet, by which time the information is outdated. In addition, an entity in trouble usually delays finalizing its financial statements. Protection for the public is accordingly not provided in any real sense, and the purpose of financial statements can only be seen as a form of tax reporting (Walton 1992:47). However, the empirical research questionnaire revealed that the majority of the CFAs agree that compliance with statements of GAAP is a price to be paid for limited liability by close corporations.

Nevertheless, those who are in favour of differential reporting argue that external users could potentially receive sufficient information from financial reports when standards are applied selectively (Kent & Munro 1999:361). However, a fundamental issue raised on differential reporting, is whether or not differential recognition and measurement standards should be considered. The alternative would be to relax presentation and disclosure standards whilst leaving recognition and measurement standards the same for all enterprises, no matter who the users of the information may be (Heymans 2000:31).

It is also the opinion of Heymans (2000:31) that the majority decision is that the measurement and recognition requirements included in international and local standards should apply equally to all entities and that only the extent of disclosure needs to be redefined. The rationale behind this argument is that a two-tier accounting system would be undesirable and confusing to users, as it would effectively reverse the harmonisation process.

This is also the view expressed by the AICPA in its report titled "Report of the Committee on Generally Accepted Accounting Principles for Smaller and/or Closely Held Businesses", as quoted by John & Healeas (2000:20), with the statement that the same measurement principles should be applied to the general purpose financial statements of all entities, because the measurement process should be independent of the nature of users and their interest in the resulting measurements. On the other hand, however, the Committee concluded that small businesses may be subject to unnecessarily extensive and financially burdensome disclosure standards (Werner, Arnstein, Culp, Nelson, Silverman, Wyatt 1976:116). Accordingly, they recognised that in order for financial statements to be comparable, measurement processes must be standard; however, what is disclosed in those financial statements should be based upon an analysis of the needs of users, rather than automatically being required of all firms (Burton & Hillison 1979:20).

The arguments raised against differential recognition and measurement rules are summarised as follows (Walton 1992:46):

- accounting rules must be universal or accounting will fall into disrepute;
- differential rules would cause problems of interpretation for users; and
- preparation of financial statements and compliance with a single set of rules is not that costly, but in any event a price paid for limited liability.

The counter-argument is that small entities have unique reporting needs and that the current form of financial reporting may not best serve the needs of their financial statement users. It is argued that the conceptual framework should incorporate more than one accounting model so that different users can be furnished with different information appropriate to their various objectives and information needs (Koppeschaar 2002:3).

According to Edey, as quoted by John & Healeas (2000:19), measurement in accounting is a matter of social behaviour which is inherently subjective because the perceptions of each individual accountant concerning future events will differ. According to him, differences in recognition and measurement methods can occur, because of different information needs. Lavigne (1999:50) further argued that it is not impossible that some recognition or measurement standards will not meet the needs of small business enterprises (SBEs) or pass the cost/benefit effectiveness test, and therefore the advisability of establishing differential recognition or measurement standards will have to be examined in each case.

The argument in favour of differential measurement rules is taken further by Lippitt & Oliver (1983:56) with the statement that the official pronouncements of the Financial

Accounting Standards Board (FASB) comprise many examples of GAAP for specific industries, meaning that accounting standards are specially tailored to address special needs, which leads to the following questions:

- If there is room for different reporting standards based on specialised industry practices, isn't there also room for those based on size? and
- The meaning of accounting concepts such as realisation, the measurement of cost, and others can vary from one industry to another, why can't some concepts vary because of size as well?

The arguments raised in favour of differential measurement rules are summarised as follows (Walton 1992:46):

- the cost of reporting bear proportionately more heavily on small firms;
- the main users of their reports can be much more easily identified and are few in number; and
- a large part of the measurement framework is based on the needs of large business.

In brief, according to the above-mentioned discussions there are a number of arguments for and against differential reporting. There are valid arguments supporting both points of view. One can thus conclude that more research needs to be done with regard to the most appropriate reporting standards for smaller entities.

Various international studies on differential reporting have already been conducted. The results of these studies play an important role in the development of differential reporting standards for close corporations and other small entities in SA. The results of these studies are analysed in the next section.

3.4 Research evidence

Research evidence on the topic of differential reporting was gathered by numerous researchers over a period of time. One of these studies includes a survey done by the Financial Accounting Standards Board (FASB) in the USA in order to identify areas for differentiation between the financial reporting of big and small businesses. The following three parties were surveyed (Lippitt & Oliver 1983:53):

- managers of private and small public companies;
- users of financial statements of private and small public companies; and
- public accountants involved with private and small public companies.

At the 1982 national meeting of the AAA, Professor Abdel-Khalik, as quoted by Lippitt & Oliver (1983:53), reported on the preliminary results of the survey sponsored by the FASB and the University of Florida which indicated that small Certified Public Accountant (CPA) firms, small businesses and bankers showed no strong interest in having separate sets of accounting standards for large and small businesses. This study, however, also revealed that many CPA firms decided to "exempt" some of their clients from certain reporting requirements. This "homemade" approach to GAAP created a potentially serious problem and confounded the results of the study in the sense that respondents who felt no need for a separate set of GAAP, only because they did not feel compelled to follow existing GAAP standards, were saying something quite different from respondents who actually followed existing GAAP standards and felt no need for separate standards for small businesses.

These findings should also be kept in mind when evaluating the results of the empirical study in chapter 5. The reason for this being that it is no longer a requirement for close corporations to comply with the Statements of GAAP in their financial statements. The opinions of the users may therefore be influenced accordingly.

Another study of nearly 700 managers of private companies, bankers and the accountants who serve them, conducted by Professor Abdel-Khalik of the University of Illinois and a team of five researchers, concluded that small private company managers, bankers and public accountants differ as to which financial accounting information they felt was relevant, useful and cost-effective for reporting purposes (FASB 1983:18). This study proved that one of the obstacles in the development process of differential reporting is the difficulty of harmonising the different information needs of the various users of the financial statements of small entities. In order to overcome this obstacle, the different user groups and their respective information needs should to be identified.

A survey of 89 small and medium-sized companies spread across a range of industries was conducted in the UK by Hussey and Hussey, as referred to by Dugdale, Hussey & Jarvis (1997:32). The results of this survey took researchers a step closer to overcoming the obstacles of harmonising the different information needs of the various user groups. This survey concluded as follows:

- A large majority of both small and medium-sized companies send a copy of their statutory financial statements to their bank, since banks represent the main source of finance for a large proportion of smaller companies. Evidence from a number of research studies showed that statutory financial statements play an important role in bank-lending decisions and it is claimed that they are also used to monitor the financial health of clients;
- Just over a fifth of all companies, whether classified as small or medium-sized, send a copy of their annual financial statements to major lenders other than banks. Although not specifically defined, these are likely to include trade creditors, business angels, venture capitalists, factors and leasing firms;
- A reasonable proportion of the medium-sized companies in the sample send a copy of their annual financial statements to major customers and suppliers. An even smaller percentage of smaller companies send their annual financial statements to the two mentioned external parties;

- A small number of companies provide a copy of their annual reports to senior managers, and an even smaller number to all employees;
- Only a small proportion of companies send out copies of their annual reports to the Inland Revenue Services. This may be because the accountant of the firm also sends a copy to this body.

The above-mentioned results confirm the conclusions reached in the previous chapter regarding the limited distribution of the financial statements of small entities.

The respondents in the research conducted in the UK were also asked to indicate how useful the statutory financial statements were as a source of management information. In order to interpret the responses to this question, information was also sought regarding other potential sources of information. In this survey a four-point scale was used: very useful, quite useful, of little use and of no use plus a N/A as a no response option. The responses were weighted and averaged and showed the following (Dugdale 1998:52):

- the most important sources of information are management accounts and cash flow information; and
- the ranking of different sorts of information is generally independent of the size of the company. There are however, two exceptions:
  - the usefulness of the annual report is ranked second by small companies, but only fifth by medium-sized companies; and
  - conversely, budgets are ranked third by medium-sized companies but only sixth by small companies.

Dugdale (1998:52) concluded that these results confirm those of earlier studies, namely that for small companies the annual report is an important source of management information. Further analysis of the data suggested that small and medium-sized companies tend either to rely on internal information, for example, monthly or quarterly management accounts, budgets, cash flow information, or on external information, for example statutory financial statements and bank statements.

These research finding are confirmed by the results achieved in the empirical study, as illustrated in chapter 5. The results show that only 55% of respondents are very dependent on financial statements for managerial information.

Moving to another user group, namely lenders, an Australian study was carried out by Kent and Munro to test the impact of differential reporting on lenders, utilising a mixed design laboratory experiment. The results indicated that the assessment of the ability of borrowers to repay as conducted by bank loan officers was not significantly affected by differential reporting. However, bankers requested additional information from borrowers when non-GAAP financial reports were presented (Kent & Munro 1999:359).

These results suggest that the information contained in GAAP and non-GAAP reports is equally useful in assessing the ability to repay a loan. The mean number of requests for additional information was, however, significantly greater for the non-GAAP reports than the GAAP reports. It was further noted that the requests for additional information did not generally relate specifically to the accounting standards not applied in the non-GAAP reports. Considerably more information relating to guarantees, security and details of the financial positions of directors and shareholders was required for non-GAAP reports. This implies that loan officers are more uncertain when evaluating non-GAAP reports and are seeking the "assurance" and "reliability" which they can obtain from GAAP reports (Kent & Munro 1999:373).

The above-mentioned statement regarding the uncertainty of loan officers when evaluating non-GAAP reports is confirmed by the empirical research study, as illustrated in chapter 5. In the research questionnaire distributed to bankers, the personnel were asked whether non-compliance of the financial statements of close corporations with the Statements of GAAP would influence their decision to provide loan facilities to close corporations, and if so, to specify. According to 71% of the respondents, non-compliance would influence their decision on the advancement of loan facilities to close corporations. They specified non-credibility of the financial statements as the overall concern.

The influence of non-compliance on the decision to provide loan facilities is an important issue and should be taken into consideration by accountants and their clients when deciding on the degree of compliance with accounting standards to apply to financial reports where compliance with GAAP is not required. Practitioners and clients must estimate the costs of providing GAAP reports instead of non-GAAP reports and supply *ex-post* additional information when borrowing from banks (Kent & Munro 1999:374).

The personnel of banks were also asked in the research questionnaire whether the presentation of non-GAAP financial statements would influence the interest rates or other bank charges when providing a loan or overdraft facilities to close corporations. The results show that according to 57% of the respondents, interest rates and/or bank charges would not be influenced by the presentation of non-GAAP financial statements.

On the other hand, those respondents who replied that interest rates and/or bank charges would be influenced by the presentation of non-GAAP financial statements, specified the following reasons:

- In the banking sector interest rates are influenced by a number of factors, for example:
  - the amount of security offered;
  - the length of the client's relationship with the bank; and
  - how the client manages his accounts.
- If the clients' financial statements are good, lower interest rates will be considered; and
- Interest rates and bank charges are risk-related.

It can therefore be concluded that indirect costs may be incurred when the financial statements of close corporations do not comply with the full set of Statements of GAAP. The reason for this being the assumed higher risks involved in the acceptance of non-GAAP financial statements. This conclusion is in accordance with those in previous chapters and should be kept in mind in the development of differential reporting standards for close corporations.

In addition to the above arguments, it was concluded by Kent & Munro (1999:373) that neither GAAP nor non-GAAP financial reports provide loan officers with the accounting measurement rules they most desire. Loan officers modify both sets of measurement rules in a variety of ways to help individual judgments and decision-making processes in the evaluation of the recovering potential of loans, illustrating the unique information needs of the bankers.

In order to identify the most preferred differential reporting method, a study group in Canada assessed the merits and deficiencies of the various alternative sets of GAAP for SBEs, namely (CICA 1999:Web page):

- Financial statements prepared in accordance with an appropriate basis of accounting other than GAAP to meet the needs of identified intended users;
- General purpose financial statements prepared in accordance with a basis of accounting other than GAAP, for example, the cash basis or tax basis of accounting;
- A new type of financial report focusing more on management decisions; and
- A single set of GAAP with differential rules for SBEs.

The findings of the consultation showed that it is not desirable to develop a separate set of accounting standards to meet the specific needs of SBEs. Of all the alternatives the study group examined, only one was acceptable to the majority of SBE financial reporting stakeholders consulted, and that is to adopt a form of differential reporting within GAAP. The parties consulted believe it is essential that SBE financial statements be prepared in accordance with a set of standards governing all Canadian enterprises, i.e. GAAP, but that the problems caused by certain problematic accounting rules for SBEs should be resolved (CICA 1999:Web page).

In this regard, the results of the empirical research questionnaire show that 81% of the CFAs that responded, replied that close corporations should have a separate set of accounting standards. They were further asked if this separate set of accounting standards should be:

- a separate accounting standard for smaller entities; or
- differential reporting listed in each statement.

Opposed to the Canadian findings, 75% of the respondents preferred a separate accounting standard for smaller entities above the differential reporting listed in each statement.

To summarize, it can be concluded that different user groups in different countries have different opinions on differential reporting. These different opinions resulted in the development of different reporting models for smaller entities in different countries. Different reporting models are briefly discussed in the next section, giving only a short overview of the different models, in order to gain a basic understanding of the advantages and disadvantages of each model.

3.5 Current differential reporting models

Currently there are broadly three different models of differential reporting:

- A comprehensive set of simplified standards;
- targeted adjustments in standards; and
- a differential reporting framework.

Each of these models is discussed briefly in the following sections.

3.5.1 A comprehensive set of simplified standards

The FRSSE in the UK is an example of this mode,l as it provides a simplified set of standards available to entities in a defined class. Another example of this method is the use of Other Comprehensive Basis Of Accounting (OCBOA), usually on tax or modified cash basis, in the financial statements of non-public companies in the USA. It is often perceived as a "simpler" alternative to US GAAP (IASB 2002:3).

Over the years, critics of this comprehensive approach have raised a number of objections, including the following (IASB 2002:3):

- Alternative approaches are often proposed to meet the perceived needs of entities and their outside accountants, not the users of their financial statements;
- Alternative approaches are sometimes based on existing reporting standards with a number of deletions, but without any consideration of additional information that might be appropriate; and
- Alternative approaches may impose hidden costs on the constituencies they are designed to serve, for example;
  - entities may find that banks charge higher interest rates in response to what they consider low-quality financial reporting; and
  - professional accountants may find that they must now learn two sets of accounting standards instead of one.

The above-mentioned objections must be adequately researched in order to prevent the development of a reporting model which causes small entities to be worse off. The needs of users must be met within the cost vs. benefits restriction.

3.5.2 Targeted adjustments in standards

In Canada and the USA a targeted approach is, or has been, used on occasion. According to this approach, specific exemptions, differential disclosure and, in very limited situations, differential measurement are combined (IASB 2002:3). Statements of GAAP are used as the basis of financial reporting for smaller entities, with differential reporting listed in the standards. These exemptions include:

- full exemption from a standard;
- partial exemption from measurement and disclosure requirements; and
- exemption from some disclosure requirements.

The objection raised against the above-mentioned method is that some critics feel that it is not appropriate to use the Statements of GAAP as the basis of financial reporting for smaller entities. They argue that the unique needs of the users of the financial statements of smaller entities might not be met by only partial exemption from some measurement and disclosure requirements. A more comprehensive method is required.

3.5.3 A differential reporting framework

A differential reporting framework is basically the same as the above-mentioned targeted adjustments in standards, with full excemption from certain standards and partial excemption from others being allowed. The difference between these methods is that the excemptions are not listed in the standards but in a differential reporting framework. Good examples of differential reporting frameworks are found in Canada and New Zealand. Both Canada and New Zealand have established mechanisms to consider differential reporting issues as new accounting standards are being developed, so that such issues may be considered in a timely and consistent manner (IASB 2002:3).

According to these countries, a key obstacle to the development of useful accounting standards for small entities is probably the premise that all commercial entities should report under the same framework. This is because it ignores the fact that, economically and commercially speaking, there is simply no comparison between large public companies and small, owner-managed entities. The argument is that although the basic nature of the transaction does not change, the framework within which it takes place is different. Its consequences may be different, and this should be accepted in designing regulations, resulting in a differential reporting framework for small entities (United Nations Trade and Development Board 2000:9).

3.6 Conclusion

The goal of differential reporting is to overcome the identified problems of accounting standards overload by providing more useful and cost-effective information to the users of the financial statements of close corporations and other small entities. During the development of differential reporting, the following difficulties were identified:

- How to identify small entities; and
- What degree of accounting modifications should be allowed in the financial statements of these entities.

It was concluded from the opinions given and discussions conducted that the best method to identify smaller entities would be to apply qualitative measures, i.e. owner-management and user profiles, combined with the requirement of consent from all the owners. A size test is not regarded as an appropriate method to identify small entities for differential reporting purposes.

The question regarding the degree of the accounting modifications to be permitted can be subdivided into three dimensions, namely recognition, measurement and disclosure. The principal question is whether the recognition and measurement requirements contained in the Statements of GAAP should be changed for differential reporting purposes, or whether disclosure requirements should only be minimised. It is also debatable whether or not these exemptions should be listed in a separate standard, or listed as part of the current standards.

It was concluded from the opinions given and discussions conducted that differential disclosure requirements are needed. However, the solution for the modification of recognition and measurement requirements is less clear with valid arguments presented both for and against differential measurement requirements.

Different differential reporting models resulted from the arguments raised regarding the alternatives for differential recognition and measurement requirements. However, more research should be conducted in order to identify the most appropriate method of reporting. To be acceptable, the reporting method should meet most of the information needs of the users of the financial statements of close corporations and other small entities, and simultaneously provide cost-effective information that would offer a fair presentation of the financial results, while taking into consideration the additional costs that may result from adopting differential reporting standards.

In order to assist in identifying the most appropriate method of reporting, a detailed analysis of the different methods of differential reporting implemented in different countries, is presented in the next chapter. A comparison between the different reporting methods will highlight the strengths and weaknesses inherent to each method. This will greatly facilitate the development of differential reporting standards for close corporations in SA.

CHAPTER 4

FINANCIAL REPORTING FOR SMALL ENTITIES: A COMPARITIVE STUDY

4.1 Introduction

In the previous chapters the different models of differential reporting developed by different countries as a result of numerous research studies conducted by a number of individuals and institutions were discussed. Researchers from a variety of countries have debated on the issues relating to differential reporting, resulting in alternative methods of differential reporting being adopted. The following countries have implemented different methods of differential reporting:

- The United Kingdom
- New Zealand
- Australia
- Canada
- The United States of America
- South Africa
- The International Accountings Standards Board

In this chapter, the different methods of differential reporting implemented by these countries are discussed.

4.2 The United Kingdom

Differential reporting in the UK consists of a complete, distinct accounting standard, specifically for smaller entities, namely the Financial Reporting Standard for Smaller

Entities (FRSSE). This standard introduced a new concept into financial reporting (ASB 1998:107).

The intention of the working group developing "little gaap" was that the proposals made should be consistent with the accounting principles and practice already laid down in the Companies Act, thereby reconciling the FRSSE and Companies Act requirements. The implication was that, within a reasonable period, the sources of "little GAAP" might consist of general principles or "ground rules" to be found in the Companies Act, together with more specific regulations or practice which would be found in accounting standards dealing with topics applicable to the generality of companies, including small ones (John & Healeas 2000:5).

In the opinion of the ASB (1997:6), the FRSSE is an attempt to balance the conflicting views of those who commented on the proposals, ranging from those who believe small companies should be exempt from all accounting standards, to those who favour retaining the *status quo*. It is an attempt to include all the guidance necessary to prepare accounts for small companies, and similar entities, in one document (Murphy 1998:64).

Furthermore, the objective of the FRSSE, as stated by the ASB (2001:9), is to ensure that reporting entities, falling within its scope, provide in their financial statements information about the financial position, performance and financial adaptability of the entities concerned. This information should be useful to users in assessing the stewardship of management and for making economic decisions. It should further be recognised that the needs of users in respect of stewardship and economic decision-making for smaller entities are different from those for other reporting entities. According to the ASB (1997:6) this should make significantly less burdensome the task of preparing the accounts of qualifying entities. These qualifying entities are identified in the next section.

4.2.1 Identifying small entities

In deciding which entities should qualify for exemption, the working party in the UK considered a number of factors, namely (Wild & Carter 1995:80):

- the extent to which there is public interest in an entity;
- the complexity of the entity;
- the separation of ownership and control; and
- size.

It was recognised that while size is not the most important factor, it is the easiest to apply.

Accordingly, it was decided that the FRSSE may be applied to all financial statements intended to give a true and fair view of the financial position and profit or loss the following entities (ASB 2001:10):

- Companies incorporated under companies legislation and entitled to the exemptions available in the legislation for small companies when filing accounts with the Registrar of Companies; or
- entities that would have fallen into the first category had they been companies incorporated under companies legislation, excluding building societies.

The definition of a small company is contained in sections 247 and 247A of the Companies Act 1985 of the UK. The qualifying conditions are met by a company in the year in which it does not exceed two or more of the following criteria (ASB 2001:78):

- Turnover £2,800,000
- Balance sheet total £1,400,000
- Average number of employees 50

For any company other than a newly incorporated company to qualify as small, the qualifying conditions must be met for two consecutive years. Accordingly, a company will cease to qualify as small if it fails to meet the qualifying conditions for two consecutive years.

Furthermore, a parent company shall not be treated as qualifying as a small company in relation to a financial year unless the group headed by it qualifies as a small group. The definition of a small group is contained in sections 248 and 249 of the Companies Act 1985 of the UK. The qualifying conditions are met by a group in the year in which it does not exceed two or more of the following criteria (ASB 2001:78):

- Aggregate turnover £2,800,000 net (or £3,360,000 gross)
- Aggregate balance sheet total £1,400,000 net (or £1,680,000 gross)
- Aggregate number of employees 50

"Net" means after the set-offs and other adjustments required by Schedule 4A of the Companies Act 1985 of the UK, in the case of group accounts, and "gross" means without those set-offs and adjustments. A company may satisfy the relevant requirements on the basis of either the net or the gross figure (ASB 2001:78).

Therefore the FRSSE does not apply to the following (ASB 2002:115):

- large or medium-sized companies, groups and other entities;
- public companies;
- banks, building societies or insurance companies;
- authorised persons under the Financial Services Act 1986 (in the UK) or the Investment Intermediaries Act 1995 (in the Republic of Ireland); or
- members of groups that contain public companies, banks, building societies, insurance companies or authorised persons under the Financial Services Act or Investment Intermediaries Act.

The above-mentioned identifies the qualifying entities in terms of FRSSE for differential reporting purposes. The accounting requirements are discussed in the next section.

4.2.2 Accounting requirements

The FRSSE provides a complete compendium of simplified versions of UK standards (Martin 2000:48). It is a condensed version of extant accounting standards and Urgent Issues Task Force (UITF) abstracts, focusing on the areas that apply to the smaller entity (Marriott 1997:33). Accordingly, it is basically a simplification of current accounting standards. These simplifications of the different Statements of Standard Accounting Practice (SSAP), Financial Reporting Standards (FRS) and UITF abstracts, range from the very minor to the very major, with others being left out altogether (Jackson 1997:75).

In the latest publication of the FRSSE, the "FRSSE - effective June 2002", the definitions and accounting treatments are consistent with the requirements of companies legislation and, for the generality of small entities, are the same as those required by other accounting standards or a simplified version of those requirements. The disclosure requirements exclude a number of those stipulated in other accounting standards (FRSSE 2002:115). The measurement bases in the FRSSE are the same as, or a simplification of, those in other accounting standards (King 1997:70).

Some of the major changes the FRSSE introduced can be summarised as follows (McAleese 2001:18):

- Simplifications as to how some transactions are recorded and measured, for example, the treatment of arrangement fees, which can now be written off as an expense rather than deducted from the liability, as required under FRS 4, Capital Instruments;
- leased assets and liabilities can be stated at fair value rather than the present value of minimum lease payments as required under SSAP 21, Accounting for Leases and Hire Purchase Contracts;
- much of the lengthy disclosure requirements of existing standards are eliminated, therefore an analysis of turnover and profits due to continuing and discontinued activities and a reconciliation of shareholders funds is no longer required; and

- the exemption from the requirement to prepare a cash flow statement, a decision that provoked controversy at the time the standard was issued.

Although the FRSSE does not include a requirement for a cash flow statement, the ASB believes that a cash flow statement is an important aid to the understanding of the financial position and performance of any entity, and the FRSSE therefore includes a "voluntary disclosures" section, recommending that smaller entities present a simplified cash flow statement using the indirect method (ASB 1997:6). This "voluntary disclosures" section is not part of the statement of standard accounting practice and, as such, is not mandatory (King 1997:70).

Entities adopting the FRSSE are automatically exempt from applying all the other accounting standards and UITF Abstracts. This considerably reduces the volume of accounting standards the entities need to comply with or refer to. However, it remains open to them to choose not to adopt the FRSSE and instead to remain subject to full GAAP Standards as before (King 1997:70).

Those entities that choose to use FRSSE have to indicate in their accounting policy note that it is the FRSSE which they are adopting, not full UK GAAP. Notwithstanding, where a smaller entity has a transaction or a situation which falls outside the FRSSE, it is required to comply with the relevant rules of the wider standards (United Nations Trade and Development Board 2001:5). However, as it is not mandatory for entities applying the FRSSE to follow it to the letter and it may be adapted accordingly (King 1997:70).

In considering the application of accounting standards and UITF Abstracts to smaller entities, the ASB has, and will continue to have, regard to the following criteria (ASB 2002:115):

- The standard or requirement is likely to be regarded as having general application and as an essential element of generally accepted accounting practice for all entities;

- The standard or requirement is likely to lead to a transaction being treated in a way that would be readily recognised by the proprietor or manager of the business as corresponding to his or her understanding of the transaction;
- The standard of requirement is likely to meet the information needs and legitimate expectations of a user of a small entity's accounts;
- The standard or requirement results in disclosures that are likely to be meaningful and comprehensive to such user. Where disclosures are aimed at a particular group of users, that group would be likely to receive the information, given that they may have access only to abbreviated accounts;
- The requirements of the standard significantly augment the treatment prescribed by legislation;
- The treatment prescribed by the standard or requirement is compatible with that already used, or expected to be used, by the Inland Revenue in computing taxable profits;
- The standard or requirement provides the least cumbersome method of achieving the desired accounting treatment and/or disclosure for an entity;
- The standard provides guidance that is expected to be widely relevant to the transactions of small entities and is written in terms that can be understood by such businesses; and
- The measurement methods prescribed in the standard are likely to be reasonably practical for small entities.

The satisfaction of a majority of the above criteria would suggest that the standard or requirement under consideration may also be appropriate for application to smaller entities, whereas failure to satisfy a majority of the above criteria would suggest that exemption, or differing treatment, from the standard, or a specific requirement within that standard, may be more appropriate (ASB 2002:115). Accordingly, it is concluded by the ASB (1997:6) that where possible the FRSSE should omit requirements that are unlikely to affect smaller entities.

Despite the relief that the FRSSE yielded, initial reactions to the FRSSE were varied, with many commentators disappointed that the standard was not more radical in its approach (McAleese 2001:18). In the next section, some of the opinions raised on the FRSSE are discussed and the strengths and weaknesses inherent to the standards are highlighted.

4.2.3 Opinions on the FRSSE

In opinion of King (1997:70) the main bonus for entities adopting the FRSSE is the reduction in disclosure requirements compared with those in the full array of accounting standards and this should help ease the compliance burden on smaller entities. However, according to Sharp (1998:74), it cannot be said that the FRSSE results in significantly shorter financial statements, because many of the disclosures were rarely or never applicable to smaller companies. Nevertheless, there is now a lot less to worry about and spend time on only to decide that the points are irrelevant after all.

Another view is that of Paterson (2001:96) who stated that apart from exemptions from disclosure requirements, the relaxation of GAAP standards as offered by the FRSSE, is more cosmetic than real. According to him there are no substantive differences in the rules on recognition and measurement, although they are sometimes described in rather more superficial terms. In addition, some of the more complex subjects that certain standards address are omitted from the FRSSE altogether. This is based on the assumption that small entities will seldom encounter such transactions, but if they do, they will have to go back to the main standards in order to find out how to account for them. He concluded that the real reason for having a separate standard for small entities therefore seems to be founded more on pragmatism than on principle. It reflects the acceptance of the ASB that the full set of standards has now become so complex that small businesses and their advisers can no longer be expected to cope with it.

A member of the CCAB working party that produced the proposals for a single standard for small companies, Professor Walton, of the University of Geneva, is of the opinion that the FRSSE is a very good step forward, except for the fact that it does not change any measurement rules for small companies. According to him, the question really ought to be what small companies need in the long term. He further identified the risk that small companies will not see how the FRSSE benefits them and furthermore that small companies do not need all the relevant economic information in their accounts. In this regard, he offered an alternative view that places the profit and loss account at the centre of reporting in owner-managed businesses. He suggested that the profit and loss account should be drawn up broadly in line with tax measurement rules, but should provide additional management information. Expenses would then be detailed and split between those allowable for tax purposes and those not allowed (ASB 1996:14).

In this regard, the research questionnaire, distributed to the members of close corporations, CFAs, bankers and SARS, identified the following regarding the preferred preparation method used for the financial statements of close corporations:

- SARS prefer the tax basis, followed by the full Statements of GAAP;
- CFAs prefer the managerial basis, followed by the tax basis; and
- Banks prefer the full GAAP followed by the managerial basis.

Accordingly, there is only some merit for the suggestion to draw up the income statement in line with tax measurement rules, because it is the preferred method by SARS. However, the preferences of the other user groups, for example the bankers and members, should also be taken into consideration when deciding on a preparation method.

Another point of concern raised lies in the fact that financial reporting is far from a static subject. Changing practice, in the form of new and revised accounting standards and UITF Abstracts, will necessitate periodic revision of the FRSSE to ensure that it is kept up-to-date (ASB 1998:106). To facilitate this process, the ASB established a standing committee, the Committee on Accounting for Smaller Entities (CASE), whose functions are to advise the ASB on accounting issues as they affect smaller entities and to recommend future revisions of and modifications to the FRSSE. The committee members represent a wide variety of interests and the aim has been to combine an appropriate blend of technical knowledge and experience from the smaller entity sector (ASB 1997:3).

With regard to the changing nature of accounting standards, Morley (2001:104) stated that the FRSSE would probably cause more work than it would save, and it would do users a disservice. The basis for his opinion is the fact that in practical terms it has been obvious from the start that this standard would require more frequent review than any other, because as every new FRS is introduced, the FRSSE will need to be updated to bring in its relevance to the smaller entity. It is suggested that it would be simpler, more straightforward and more meaningful if every accounting standard could include a paragraph setting out its relevance and applicability to smaller and medium-sized entities.

The above concern is confirmed by the following (Morley 2001:104):

- The original FRSSE, published in 1997, was first fully reviewed, just over a year later, in December 1998;
- In July 1999 the ASB issued an ED to revise the standard once more, and this revision became a standard in November 1999;
- In June 2000, yet another draft revised FRSSE appeared; and
- In February 2001 the ASB issued a discussion paper on the future of the FRSSE. After three years its place in the armoury of accountants was being reconsidered, because of the amount of negative feedback received on the usefulness of the standard.

Even though a separate accounting standard for smaller entities may result in more work, this is also the method used in SA in the proposed LPFRS. This method is also preferred by the CFAs in SA, as concluded from the results of the empirical research study that will be discussed in chapter 5.

Further research was done on the FRSSE and a study funded by the Irish Accountancy Educational Trust revealed that the FRSSE has failed in its attempt to reduce the compliance burden for SMEs and small and sole practitioners (Malvern 2001:Webpage). The Irish study was designed to elicit the views of accountancy practitioners in Ireland, North and South, who prepare and audit the financial statements of small companies and revealed that the same perceived burden of financial reporting still exists (McAleese 2001:18).

The results of the study can be summarised as follows (McAleese 2001:18):

- Accountancy firms still find keeping up to date with the growing number of accounting standards a burden on their firm, and this tends to be a greater burden on small firms and sole practitioners than on larger practices;
- Both the compliance costs for the firms involved and fees charged to clients have not changed as a result of using the standard;
- Because the cost and time savings are minimal and the standard is optional, practitioners see no advantage in changing account formats which were already in place;
- Many respondents believe that the FRSSE is simply another standard to be absorbed and learned;
- The burden of too many accounting standards was the most significant deterrent in the decision of applying the FRSSE;
- The majority of practitioners are dissatisfied with the current accounts format. They favour a new style of small company report which would provide information more suitable to the users' needs. Submissions on the format of this new style of report focused on a simple short report, providing basic financial information and a performance history of the company using ratio analysis and graphical representations and concentrating on adhering to basic accounting concepts rather than complying with technical accounting standards. Their second choice was to continue using the FRSSE, closely followed by complete exemption from all accounting standards for small companies, and lastly, to revert back to the main body of accounting standards.

It is concluded from the study by McAleese (2001:18) that the FRSSE is not sufficiently effective in its present format. Some radical changes are needed if it is to fulfil its original objective of simplifying accounting procedures and significantly reducing the burden of financial reporting on small companies.

However, on the positive side, the study revealed that the current users of FRSSE have not encountered many difficulties in the application of the FRSSE. The highest proportion of the users thereof are small firms and sole practitioners, whose client bases consist mainly of small companies which are expected to stay small in size (McAleese 2001:18). It was further revealed that the most important factor in the decision of a firm to apply the FRSSE is the reduced disclosure requirements, followed by ease of use (Malvern 2001:Webpage).

Another survey was conducted by the Institute of Chartered Accountants of Scotland (ICAS) at the request of the ASB. They were asked to determine the extent to which the FRSSE was being used. Eligible companies were selected at random from the Scottish company register and their financial statements were reviewed. The survey revealed that 43 of the 100 companies selected were making use of the FRSSE, despite the standard not being mandatory (ICAS & ICAEW 2000:Webpage).

The Institute of Chartered Accountants in England and Wales (ICAEW) also reviewed the feasibility of the FRSSE. The following feedback was given (ICAEW 2001:2):

- The FRSSE is widely used and generally valued by practitioners;
- The proportion of small entities adopting the FRSSE is likely to continue to grow, particularly in view of the proposal to abolish the option for small companies to file abbreviated accounts;
- There are costs associated with the operation of a separate reporting regime, but it is considered that the benefits significantly outweigh these costs;
- They believe that in general, the FRSSE has been a great success and they consider substantive changes to the content of the FRSSE to be unnecessary. However, they

recommend a number of general improvements to the FRSSE, including the provision of illustrative and realistic examples relevant to the circumstances of smaller entities;

- They believe that the central pillars of the credibility currently enjoyed by the FRSSE are the key objectives that should be making application of the requirements of accounting standards less complex and reducing disclosure to a minimum, whilst preserving consistency of measurement and recognition principles, and therefore the ASB should not move them lightly;
- They further concluded that the FRSSE financial statements provide their primary users with more understandable information, and moreover, the information is easier and cheaper to produce. At the same time, the integrity of small companies' reporting has not been compromised. However, they recognised that the increasing complexity of accounting standards may necessitate some changes to the style and structure of the FRSSE, for example the introduction of accessible "gateways" as an aid to understanding the likely implications of complicated subjects. These gateways within the FRSSE would introduce and explain more difficult concepts;
- However, whilst the FRSSE should be as clear and accessible as possible to readers who lack familiarity with more complex accounting issues, they believe that consistency with the language of Big GAAP is generally desirable. Paraphrasing Big GAAP, or even making apparently insignificant changes in wording, may lead to uncertainty or unintended differences in meaning or interpretation. Whilst some use of simplified language may be appropriate, they believe that changes should not be made lightly to the wording used in other standards.

The ICAEW also published its views on the future of the FRSSE, after a consultation process that indicated that the standard is widely used and generally valued by practitioners. Their views can be summarised as follows (Sleigh-Johnson 2001:92):

- FRSSE financial statements are easier and cheaper to produce - the standard is a "one-stop shop", a single, coherent and convenient financial reporting guide for preparers;

- The standard makes application of the requirements of Big GAAP less complex and reduces disclosure to a minimum, while largely retaining the recognition and measurement bases of Big GAAP; and
- Accounts prepared in accordance with the FRSSE can provide information that is more meaningful and understandable to users.

It is also the opinion of Sleigh-Johnson (2001:92) that the FRSSE helps small companies produce more useful and understandable information. However, it is further believed that the FRSSE is not perfect, and change is inevitable in view of further developments. Nevertheless, radical solutions will take many years to achieve, but the Institute of Chartered Accountants of Scotland (ICAS) took the first step (Sharp 1998:74). They published "Breaking the Code & A Better Reporting Framework for Small Companies" in October 1998 and within it proposed a radical rethink and restructure of financial reporting procedures for small companies. The consultation paper based its proposals on unlocking the coded information given in small company accounts by focusing on the key information needs of the users of those accounts (ICAS & ICAEW 1999:Webpage).

The approach followed by the ICAS was described as a "blue-sky" one, because rather than beginning with the existing regime and refining this into a more useful format, they started from a blank sheet of paper. Their approach focuses on the users of small company accounts and distinguishes between those with economic power and those without such power who therefore can access only the information available to the general public. Their model meets what they believe are their legitimate information needs, while taking into account the costs associated with the preparation of such information (ICAS's Small Companies Working Party 1998:3).

The ICAS further identified that key user information needs are based on providing assurance for the users. In particular, they believe that users need assurance on the following (ICAS's Small Companies Working Party 1998:3):

- The profitability of the company;

- The solvency of the company;
- What happened to the company in the year under review;
- The future prospects of the company; and
- The quality of the management of the company.

The model of the ICAS has been developed specifically to address the needs of these users. They proposed that a reporting framework should be developed based on the following four statements (ICAS's Small Companies Working Party 1998:3):

- A statement of basic company information;
- A management statement;
- A statement of the objectives and policies of the company with regard to its stakeholders; and
- An independent financial commentary on its results, financial position and future prospects.

In response to comments received on the Consultation Paper, the Working Party, comprising members of ICAS en ICAEW, recommended in their report, "Getting into Shape", that a new category of micro company should be formed for non-public interest companies with a turnover of up to £350k and total assets up to £1,4m, the size criteria being a surrogate for being owner-managed. Even though the use of further criteria could be considered, the Working Party, having explored numerous alternatives, concluded that the size criteria were likely to be the fairest and easiest to use (ICAS & ICAEW Small Companies Working Party 1999:2). The Working Party further recommended that micro companies should have minimal company law obligations, and the only financial information filing requirement would be for a few balance sheet extracts from their unaudited tax return within twelve months of the year end (ICAS & ICAEW 1999:Webpage).

These recommendations identify the need for an additional distinction between small and micro entities and the need for further simplifications regarding the reporting requirements for micro enterprises. This concept was implemented by the IASB, and is further discussed in section 4.8.

In short, it is the opinion of King (1997:70) that the FRSSE is designed to cater for the needs of nearly all smaller entities and to provide a single reference point for a significant majority of smaller entities. To be relevant, it omits requirements that are unlikely to affect smaller entities. However, as was seen from the numerous opinions raised, the FRSSE is not the ideal solution, because:

- Firstly, it uses size to distinguish between small and large entities;
- Secondly, it is mostly only disclosure requirements that are changed; and
- Thirdly, it is structured as a separate standard and accordingly, has to be reviewed frequently to accommodate changes in big GAAP.

Nevertheless, useful information was gathered from the opinions raised on the FRSSE that can be of use in the development of differential reporting in SA. In the next section the differential reporting guidelines implemented by New Zealand are analysed to gather further useful information.

4.3 New Zealand

Differential reporting was first introduced in New Zealand in 1994 (Santoro 1997:23). The "Framework for Differential Reporting" was issued by the Institute of Chartered Accountants in February 1994 (Nexia International, Spicer & Oppenheim 1997:273). A revised framework for differential reporting was released in April 1997, and applies to financial reporting periods ending on or after 31 December 1997, although early adoption was permitted (Santoro 1997:23).

Differential reporting in New Zealand was developed by the Institute of Chartered Accountants in an attempt to balance the costs of producing financial statements with the benefits to users of those financial statements (Nexia International, Spicer & Oppenheim 1997:284). It is further concluded by Ernst & Young (1997:85) that the differential treatment is justified on the basis of the benefits and costs of compliance with financial reporting standards.

The Framework is the design of the Financial Reporting Standards Board (FRSB). They adopted a "top-down" approach, which can be contrasted with the FRSSE of the UK. A top-down approach prescribes comprehensive requirements for large entities, and then eliminates some requirements for smaller entities, i.e. targeted adjustments. According to Baskerville & Simpkins (1997:14), this Framework, compared with frameworks in other jurisdictions, provides proof of pragmatic and clear thinking about what constitutes the necessary reporting requirements for small or closely-held entities.

In order to identify the qualifying entities for differential reporting, the Framework for differential reporting includes eligibility criteria similar to those of the UK, but also includes as a further criterion the involvement of all owners of an enterprise in its governing body (Martin 2000:48). These requirements are discussed in the next section.

4.3.1 Identifying small entities

In the Framework for differential reporting it is stated that for an entity to qualify for differential reporting, the following criteria must be met (Nexia International, Spicer & Oppenheim 1997:284):

- It must not be publicly accountable; and
- Either
  - Should have no separation between the owners and the governing body on the balance sheet date; or
  - Should not qualify as large during either the current of preceding account period.

An entity is publicly accountable if at any time during the current or preceding period the entity was an issuer as defined in the Financial Reporting Act 1993 (FRA), or the entity has the coercive power to tax, rate or levy to obtain public funds. Further, for there to be no separation between the owners and the governing body of an entity, every owner must also be a member of the governing body (Nexia International, Spicer & Oppenheim 1997:284). In respect of the size criteria, an entity is small if it meets any two of the following criteria (Santoro 1997:23):

- Total revenue does not exceed $5 million;
- Total assets do not exceed $2,5 million; and
- There are not more than 20 employees.

For the purpose of the application of the size criteria, the total revenue and total assets are determined after the application of any allowable exemptions permitted by the Framework, and employees are only paid employees. The Framework further noted that the size criteria would be reviewed regularly. The FRSB has clarified that when the size criteria are amended, entities which were previously "large" will be able to apply the revised size criteria in the first year of application. Normally such entities must meet the size criteria for two consecutive periods (Baskerville & Simpkins 1997:15).

In order to determine the utilisation of the criteria used to distinguish entities for differential reporting, a survey of 120 chartered accountancy firms were carried out by Campbell and Rainsbury. Their report, as quoted by Baskerville & Simpkins (1997:14), highlighted that the criterion allowing exemptions by virtue of being "closely held" was used more often than the "small" criterion (55% compared with 44%). This is a further indication that size is probably not a relevant criterion, when it comes to the differentiation between entities for the purpose of differential reporting.

After the identification of the qualifying entities for differential reporting purposes, the next step was to identify the accounting requirements applicable to these qualifying entities. These accounting requirements are analysed in the next section.

4.3.2 Accounting requirements

The Framework for differential reporting allows for certain entities to be exempt from certain financial reporting disclosures and accounting practices (Ernst & Young 1997:85). Appendix 1 of the Framework, which lists the exemptions available to qualifying entities, has been grouped into 3 categories, namely (Baskerville & Simpkins 1997:17):

- Full exemption;
- Partial exemption; and
- No exemption.

This means that qualifying enterprises are fully exempt from the application of certain accounting standards and are also entitled to partial exemptions from other standards (Prinsloo 2000:2). Qualifying entities may further comply selectively with provisions of standards from which they are exempt when this will not affect recognition and the measurement of elements. Selective disclosures may be made, but the selected disclosure must still be in accordance with the relevant standard. Furthermore, selective disclosures may be made without an entity being compelled to comply fully with the relevant standard (Baskerville & Simpkins 1997:16).

In respect of the full exemption, entities which qualify for differential reporting are exempt in full from the following reporting standards (Nexia International, Spicer & Oppenheim 1997:284):

- Statement of Cash Flows;
- Accounting for Income Tax;
- Accounting for Research and Development Activities;
- Financial Reporting for Segments; and
- Disclosure of Information about Financial Instruments.

Exemptions from part of the other reporting standards are also available. In addition, whenever an entity has taken advantage of differential reporting exemptions, it must disclose the fact that it has done so.

In respect of the requirement of fair presentation, the Framework states as follows: "Differential reporting is consistent with legal requirements for financial reports to comply with generally accepted accounting practice. In the rare circumstances that compliance with generally accepted accounting practice does not result in the financial reports giving a fair presentation, additional information and explanations are to be provided in order to give a fair presentation" (Baskerville & Simpkins 1997:16). This is to ensure that differential reporting still results in a financial report that is a fair presentation of the underlying transactions.

It is concluded by Baskerville & Simpkins (1997:14) on the differential reporting method implemented in New Zealand, that it is arguably the most comprehensive method of allowing differential reporting among the major standard setting jurisdictions, because the New Zealand Framework:

- allows large closely-held entities to be eligible for exemptions;
- allows measurement of elements to be included in some exemptions; and
- does not require cash-flow statements for eligible entities.

It is also the opinion of Ernst & Young (1997:85) that the Framework for Differential Reporting is well accepted in New Zealand and that entities that qualify for differential reporting generally take advantage of the disclosure exemptions. Furthermore, results from the survey carried out by Campbell and Rainsbury, as quoted by Baskerville & Simpkins (1997:15), showed that respondents generally considered that the Framework works well in providing a large number of entities with relief from some financial reporting requirements.

Another method of differential reporting in New Zealand is contained in the New Zealand Financial Reporting Act (FRA No 106). It was introduced from 1 July 1994, listing reporting obligations for exempt companies. It is stated by Nexia International, Spicer & Oppenheim (1997:274) that the financial statements of exempt companies are neither required to comply with GAAP nor is a true and fair view required. Basically a statement of financial position, a statement of financial performance and some accompanying notes are required. The reason for these exemptions being that companies that qualify as exempt companies are usually very small, and as such require only minimum disclosures (Nexia International, Spicer & Oppenheim 1997:284).

The distinction between small en very small entities is in agreement with the proposal by the ICAS in their report "Getting into Shape", which includes exemptions for micro companies. This is also in agreement with the method proposed by the IASB, which is discussed in section 4.8. The differential reporting guidelines implemented in Australia are analysed in the next section.

4.4 Australia

Differential reporting has been implemented in Australia since June 1992 with the publication of the following documents (Kent & Munro 1999:360):

- Statement of Accounting Concepts 1 (SAC 1) "Definition of the Reporting Entity";
- Approved Accounting Standard AASB 1025 "Application of the Reporting Entity Concept and Other Amendments"; and
- Amendments to the Corporations Law of 1989.

The approach to differential reporting adopted in Australia by SAC 1 and AASB 1025 is based on a "reporting/non-reporting" entity dichotomy with those entities classified as "reporting" entities, required to comply with all the accounting standards.

A reporting entity is defined in AASB 1025 in paragraph 27 as an entity in respect of which it is reasonable to expect the existence of users dependent on general purpose financial reports for information which will be useful to them for making and evaluating decisions about the allocation of scarce resources (Newitt 1990:50). Accordingly, the entity concept enunciated in SAC 1 is linked to the common information needs of external users dependent on general purpose financial reports (GAAP) (Kent & Munro 1999:361). This means that the classification as a reporting entity requires the identification of users dependent on published financial reports for accounting information. In order to do this, SAC 1 of the conceptual framework suggests three factors that indicate reporting entity status (Campbell 1996:22):

- Separation of management from ownership and the number of owners/shareholders;
- Financial attributes such as size, in terms of sales and/or assets, and the level of debt; and
- Political and economical importance.

It is clear from the above that classification as a reporting entity is subjective rather than objective.

Those entities classified as "non-reporting" by default, can depart from accounting standards and legitimately provide a relatively lower level of disclosure in their financial reports compared to "reporting" entities. Accordingly, it is concluded by Holmes *et al.*, as quoted by Kent & Munro (1999:360), that non-reporting entities can effectively and selectively choose the accounting standards they adopt when preparing financial reports.

The First Corporate Law Simplification Bill further applies an objective test to determine which companies should be required by law to prepare financial reports. This test links public financial accountability to the size of the company and its significance in the community, rather than focusing on its legal structure. The Bill enables small business managers to calculate precisely whether their companies are required to prepare and lodge financial statements (Govey 1995:58). In short, the law allows differential reporting based on a classification of companies which depends on measurable characteristics (Campbell 1996:22).

In preparing the Bill, the Task Force gave detailed consideration to the views of the accountancy bodies that the reporting entity test should be used, rather than the small/large test. However, it was concluded that there are a number of difficulties associated with the application of the reporting entity test, namely that it is regarded as flexible and subjective, and it is less certain whether any particular company satisfies the test (Govey 1995:58). Accordingly, a more objective test, namely measurable characteristics, was selected.

In short, Campbell (1996:22) stated that the classification of entities, which is not necessarily mutually exclusive, affects the form and content of Australian financial statements. The different accounting implications for these different classifications of entities are discussed in more detail in the following sections.

4.4.1 Reporting entities

Only reporting entities, defined as entities in respect of which it is reasonable to expect the existence of users dependent on general purpose financial reports for information, which will be useful to them for making and evaluating decisions about the allocation of scarce resources, need to comply with the mandatory accounting standards issued by the AASB. Reporting entities also include "disclosing entities" as described in section 4.4.3 below (Campbell 1996:22).

4.4.2 Non-reporting entities

A company which is not a reporting entity is only required to comply with those AASB standards that the directors deem necessary in order for the financial statements of the company to present a true and fair view. The overriding concern is that the financial statements of a company show a true and fair view of the state of affairs and results of the company, for the financial period, in accordance with the reporting framework adopted and disclosed in the financial statements (Nexia International, Ashton Read, Calabro Partners, Carson McLellan, Forsythes, Lord&Brown, Nelson Wheeler, Norton-Smith Waldhauser, Ord Partners 1997:32). In short, full compliance, partial compliance, or total non-compliance, with the exception of AASB 1025, is permitted in preparing financial reports for a non-reporting entity (Kent & Munro 1999:366).

4.4.3 Disclosing entities

Disclosing entities need to comply with mandatory accounting standards issued by the AASB as per section 4.4.1. These are entities which issue "enhanced disclosure securities". These securities include securities quoted on a stock exchange, securities issued pursuant to a prospectus and a public issue of debentures. It is further expanded that disclosing entities need not be companies and that non-corporate entities are required to comply with mandatory accounting standards. Furthermore, only disclosing entities need to prepare both half-yearly and annual accounts (Campbell 1996:22).

4.4.4 Public companies

These are defined as companies other than proprietary companies and must prepare and lodge audited accounts. Public companies need to comply with full AASB standards only if they are reporting entities (compare Prinsloo 2000:3). Reporting entities are defined in section 4.4.1 as entities in respect of which it is reasonable to expect the existence of users dependent on general purpose financial reports for information.

4.4.5 Large proprietary companies

Proprietary companies are large where the company and its controlled entities have any two of the following characteristics (Campbell 1996:22):

- Consolidated gross operating revenue of $10 000 000 or more;
- Consolidated assets of $5 000 000 or more;

- 50 or more employees.

These companies must lodge annual, audited accounts with the ASC. However, only large proprietary companies that are also reporting entities need to comply with AASB accounting standards.

The size test must be applied at the end of each year in accordance with the applicable accounting standards, even if the company is a non-reporting entity. Gross assets are the total current and non-current assets, measured at their carrying values. The employees include any part-time employees as an appropriate fraction of a full-time equivalent (The Institute's Technical Standards Staff 1996:56).

It is further required that large proprietary companies have to prepare financial statements within four months of the end of the financial year. The only exceptions are for wholly-owned subsidiaries, which may be eligible for relief from the requirement to prepare and lodge financial statements under the wholly owned subsidiary class order. The Corporations Law further requires financial statements to be made out in accordance with applicable accounting standards. Accordingly, companies which are not reporting entities still only have to adopt those provisions that they perceive are relevant to the users of their accounts, i.e. prepare "special purpose" rather than "general purpose" financial reports (The Institute's Technical Standards Staff 1996:56).

4.4.6 Small proprietary companies

Small proprietary companies are proprietary companies other than large proprietary companies. A small proprietary company is not required by the Corporations Law to prepare annual accounts, unless it is a subsidiary of a foreign entity which does not lodge consolidated accounts with the ASC, or unless requested to do so by either 5% of its shareholders or the ASC. Furthermore, these requests by shareholders or the ASC must state whether accounts need to be audited and whether compliance with AASB standards is required (compare Holmes, Kent & Downey 1991:125).

In the opinion of Nexia International, Ashton Read *et al.* (1997:31) small proprietary companies are in general not required to prepare statutory financial statements at all. Nevertheless, if a company does not prepare financial statements, it must still keep proper accounting records. Furthermore, the Corporations Law may require financial statements from small proprietary companies in certain circumstances (The Institute's Technical Standards Staff 1996:56).

In the event of election by the directors to prepare financial statements, or if they do so to comply with other requirements such as the memorandum and articles of the company, then the format of the statements and whether to apply the accounting standards are decisions for their own discretion. Obviously if other requirements stipulate that financial statements should be prepared, they may also specify the format to be followed or that accounting standards be applied (The Institute's Technical Standards Staff 1996:56).

In the opinion of Govey (1995:58) the preparation of accounts by small proprietary companies will be a matter of internal management or satisfaction of the requirements of taxation legislation and creditors. This opinion is taken further by McCahey and Ramsay, Holmes *et al.* and Newitt, as quoted by Kent & Munro (1999:366), who state that all business operations in Australia are required to prepare financial reports for taxation purposes. This results in the conclusion that the report preparation method generally used by privately owned companies and non-corporate entities is a taxation basis method which includes compliance with some accounting standards.

To summarize, the differential reporting standards implemented in Australia is an example of targeted adjustments, with either full compliance, partial compliance, or total non-compliance permitted for certain types of entities. Another example of targeted adjustments is the differential reporting concept implemented in Canada. The method implemented in Canada was also used as a basis for the development of LPFRS in SA, and is analysed in the next section.

4.5 Canada

The introduction of differential reporting represented a fundamental change to Canadian GAAP, because previously Handbook Sections generally applied in the same way to all profit-oriented enterprises. The development process started with a research project initiated by the Accounting Standards Board (AcSB) of the Canadian Institute of Chartered Accountants (CICA) in 1998 (CICA 2001:1).

The research project was commissioned by the AcSB to examine how the financial information needs of providers of capital to small business entities (SBEs) might be more effectively met and the degree to which reporting in accordance with generally accepted accounting principles (GAAP) could be modified to meet these needs, rather than dealing on a piecemeal basis with those aspects of the standards that were of concern to SBEs (Lavigne 1999:49). The research project resulted in the approval of a new Handbook Section 1300, "Differential Reporting" and a few related amendments to certain Handbook Sections, in December 2001 by the AcSB, to set out the available differential reporting options (SAICA 2002:3).

This new accounting Section introduced differential reporting into Canadian GAAP on the basis of cost/benefit considerations, with the cost/benefit trade-off assessed by the AcSB in relation to the profile and needs of the users of the financial statements of enterprises (CICA 2002:Webpage). While any evaluation of the needs of financial statement users and the benefits and costs of financial information is substantially a matter of judgement, the AcSB has expressed the following view (CICA 2001:Webpage):

- The more widely spread the ownership of an enterprise and the greater the separation between its management and its owners, the greater the benefits likely to be derived from financial information;
- The smaller the group of users of the financial statements of an enterprise and the greater their ability to gain access to information in addition to that provided in the financial statements, the smaller the benefits to be derived from financial information; and
- The smaller the group of users of the financial statements of an enterprise benefiting from financial information and the greater the costs of compliance with accounting requirements relative to the number of users, the greater the likelihood that the costs of providing the information will exceed its benefits.

The above-mentioned views were also used as a basis to identify small entities for differential reporting purposes. This is discussed in the following sections.

4.5.1 Identifying small entities

Under the Handbook Section 1300, enterprises without public accountability, with the unanimous consent of their owners, may apply some or all of the differential reporting options provided in certain recommendations, when preparing financial statements in accordance with GAAP (CICA Accounting Standards Board 2002:2). Therefore, the characteristic used to identify small entities is that of non-public accountability, but with the added condition of owner consent.

The owners include those not otherwise entitled to vote and consent must be given prior to the date of completion of the first financial statements to which they apply (CICA Accounting Standards Board 2001:2). Consent may remain in force unless rescinded, or until ownership or the selection of differential reporting options changes. This is to protect the position of non-managing owners for whom financial statements may be the primary source of information. When all owners consider that differential reporting fulfils their needs, this signals that owners consider the costs of applying certain accounting requirements to exceed the benefits to their enterprise and to themselves (Mersereau 2002:32).

The public accountability criterion encompasses public share ownership, public debt and other forms of public interest. Accordingly, public enterprises are excluded from the scope of differential reporting, but so are co-operative business enterprises, regulated financial institutions (and regulated financial institution holding companies), rate-regulated enterprises, government business enterprises and government business-type organisations. Differential reporting does not apply to not-for-profit entities whose particular reporting needs have already been dealt with (Mersereau 2002:32).

An interesting observation is that there is no size cap. The AcSB deliberated whether size should be a criterion for differential reporting, but rejected a size test, because differential reporting is justified by the characteristics of users, rather than by characteristics of the enterprise. Furthermore, regardless of their size, all non-publicly accountable enterprises share a common feature that distinguishes them from publicly accountable entities: they have a narrower range of users of their financial statements (Mersereau 2002:32). Therefore, non-public accountability was chosen as the optimal differentiation method to identify small entities. This is in agreement with the conclusion reached in the previous chapter.

After the identification of small entities, the differential reporting options that may be available to these entities, were decided on. Accordingly, in the next section, the accounting requirements applicable to these small entities are analysed.

4.5.2 Accounting requirements

Canadian Differential reporting allows for partial differentiation in the application of GAAP by making available to qualifying enterprises specified reporting options tailored to the needs of the users of the financial statements of those enterprises. In accordance with the FRSSE in the UK, these differential reporting options are optional (CICA 2001:4)

Canadian differential reporting has developed on the basis that in developing an accounting standard, the Board considers whether its requirements should apply to all enterprises or whether different requirements should apply to different types of enterprises for which the cost/benefit trade-off differs significantly. On the basis of an assessment of the needs of financial statement users and under specified conditions, certain identified types of enterprises may either be (CICA 2001:Webpage):

- Granted full or partial exemption from an Accounting Recommendation, Accounting Guideline or Abstract of Issue Discussed by the Emerging Issues Committee; or
- Permitted to apply an alternative treatment under one of those pronouncements.

Selective application of the individual differential reporting options is also permitted (CICA 2002:Webpage). A qualifying enterprise may select which of the differential reporting options to apply in preparing its financial statements. The selection of differential reporting options, as approved by all the owners, establishes the basis for the preparation of the financial statements of the enterprise within GAAP (CICA Accounting Standards Board 2001:1). In short, it is the opinion of Cairns (2001:100) that enterprises that qualify for differential reporting are able to apply exemptions from some standards and use alternative treatments.

The differential reporting options approved by the AcSB in December 2001 are as follows (SAICA 2002:3):

- Section 1590, Subsidiaries: use of the equity method or the cost method, instead of consolidation;

- Section 3050, Long-term Investments: use of the cost method, instead of the equity method;
- Section 3055, Interests in Joint Ventures: use of the equity method or the cost method, instead of the proportionate consolidation method;
- Section 3240, Share Capital: limitation of the disclosure to issued classes of shares;
- Section 3465, Income Taxes: use of the taxes payable method with new disclosures;
- Section 3860, Financial Instruments - Disclosure and Presentation: presentation of redeemable preferred shares issued in specified tax planning arrangements as equity and limitation of fair value disclosures to financial assets and liabilities for which fair value is readily obtainable.

The AcSB also approved the following clarifying amendments that have general application as a result of its discussions of differential reporting issues (SAICA 2002:3):

- An amendment to Section 3475, Discontinued Operations, clarifying that a component of an entity would not meet the definition of a business segment if its activities, assets and results of operations were not separately determined prior to the date on which management adopts a plan of disposal; and
- An amendment to Section 1751, Interim Financial Statements, clarifying that enterprises not subject to a periodic interim reporting requirement prepare interim financial information on a year-to-date basis and may present annual comparatives when the year-to-date comparatives have not been previously prepared.

In addition, a qualifying enterprise that elects to use differential reporting options is required to disclose in its summary of accounting policies the fact that it has adopted differential reporting and to identify which differential reporting options it has applied (Mersereau 2002:32). Accordingly, enterprises adopting differential reporting would continue to describe the basis of accounting as being GAAP and would disclose information about the choices they have made from among the permitted options (CICA 2001:1).

To summarize the Canadian differential reporting is a combination of targeted adjustments in statements and a differential reporting framework. Entities that qualify for this differential reporting must have non-public accountability, and the unanimous consent of their owners. Regarding the gradation of this method of differential reporting, it is concluded by the AcSB that it appropriately addresses the standards overload issue for non-publicly accountable enterprises, because the conceptual underpinning for Canadian differential reporting is based on an assessment of user needs and cost/benefit considerations (CICA 2001:1).

In the next section yet another method of differential reporting is discussed. This comprises the comprehensive set of simplified standards available in the USA.

4.6 The United States of America (USA)

In the USA differential reporting has a long history. During the development process, the board of directors of the American Institute of Certified Public Accountants (AICPA) established a special committee on accounting standards overload (Hepp & McRae 1982:53). This special committee encouraged wider use of the income tax basis of accounting by business entities that for whatever reasons do not require GAAP financial statements. Even so, it is accentuated by Hepp & McRae (1982:58) that the special committee did not recommend that the income tax basis of accounting supplant GAAP in any situation. The income tax basis was offered only as a potential alternative in situations in which GAAP financial statements are regarded as not necessary.

At present USA standards are by law only applicable to public companies (Mersereau 2002:30). As a result, there has been little interest in developing differential reporting principles, as USA GAAP are primarily used by public companies and other enterprises that are required by law to apply GAAP. Small business enterprises use a comprehensive basis of accounting other than GAAP, in many cases a tax basis, for preparing their statements (SAICA 2002:5).

In addition, the auditing standards issued by AICPA allow practitioners to issue an audit report on financial statements prepared in accordance with a set of accounting rules other than GAAP, referred to as the Other Comprehensive Basis of Accounting (OCBOA). Accordingly, it is the opinion of Connolly (1998:26) that the OCBOA is regarded as important, because it is also one of the bases on which CPAs can offer opinions on financial statements.

The growing use of the OCBOA, usually on tax or modified cash basis, in the financial statements of non-public companies is often perceived as a "simpler" alternative to generally accepted accounting principles (IASB 2001:Webage). Nevertheless, the disclosure required of OCBOA financial statements is, for the most part, similar to that for financial statements prepared under GAAP. The following summarises the reporting requirements for OCBOA financial statements (Babcock 1998:52):

- the financial statements should include in the accompanying notes a summary of significant accounting policies that discusses the basis of presentation and describes how that basis differs from GAAP. The differences between GAAP and OCBOA financial statements are, however, not required to be quantified;
- the financial statements should be appropriately titled so as not to imply that they are GAAP-based financial statements;
- a statement of cash flows is not a required financial statement in a OCBOA presentation. However, if a statement of cash receipts and disbursements is presented, it should be in the general format of a GAAP presentation;
- the disclosures in the financial statements could be communicated by substituting more qualitative information for the specific quantitative information that GAAP requires;
- the financial statements should follow the GAAP presentation format for financial statements as set out in professional standards or provide information that communicates the substance or those requirements; and

- when preparing the financial statements, accountants must exercise judgement in determining what is considered "similar informative disclosures", with professional standards under GAAP as the guideline.

It is the opinion of the Private Companies Practice Section, Special Task Force on Standards Overload, that the growing complexity of GAAP was prompting many enterprises to decide to prepare their financial statements in accordance with an OCBOA. Even so, the report of the Task Force that was issued by the AICPA in August 1996 emphasized the importance of more effectively informing practitioners about the option of preparing reports on OCBOA financial statements, since these engagements are one way to meet the needs of small enterprises in a timely and cost-effective manner (Prinsloo 2000:3).

On the other hand, the Financial Accounting Standards Board (FASB) of the USA also addressed small enterprise financial reporting (Prinsloo 2000:4). The FASB recognized that some of its requirements should not apply to some enterprises, and has limited its scope accordingly (Martin 2000:48). It is acknowledged that the cost of accounting requirements falls disproportionately on small enterprises because of their limited accounting resources and need to rely on external professionals to prepare their financial statements. In addition, the FASB committed to consider potential disclosure differences between large and small companies on a case-by-case basis (SAICA 2002:3).

Accordingly, the FASB opted for a targeted approach that combines specific exemptions, differential disclosure and, in very limited situations, differential measurement. In some cases, the FASB changed the provision of a standard for all entities in response to concerns raised by small entities. However, the principal objection against this targeted approach of the FASB was that it did not meet the perceived need, as indicated by the widespread use of tax-basis and modified cash-basis accounting by smaller entities (IASB 2001: Webpage).

In conclusion, one of the differential reporting options available in the USA allows for non-public companies to prepare financial statements in accordance with the Other Comprehensive Basis of Accounting, that are either tax-based or modified cash based. This option can be regarded as one of the most comprehensive ways to meet the needs of small enterprises on a timely and cost-effective manner. However, the credibility of the statements may be questioned by some, especially banks in providing loan facilities and Revenue Services when assessing entities for tax.

This question concerning the credibility of the financial statements is one of the reasons why it was decided in SA not to use the comprehensive set of simplified standards as a basis for the development of the LPFRS. The LPFRS as differential reporting method developed in SA is analysed in the next section.

4.7 South Africa

In the development of South African corporate law, the Close Corporations Act 69 of 1984 is of significant historical importance and forms the basis for a different way of thinking about small entities. The introduction of the close corporation took South African corporate law a large step forward in providing for the reasonable needs of the typical small businessman (Cilliers, Benade *et al.* 2000:574).

The main objective of the Close Corporations Act is described by Naude, and quoted by Delport & Pretorius (1990:1), is to provide a simpler and less expensive legal form for the single entrepreneur or few participants, designed with a view to his or their needs and meaningful in his or their circumstances. Accordingly it is concluded by Naude, Brooks, Henning, Viljoen, Van Breda, De la Rey (1995:11) that the purpose of the close corporation is to simplify requirements and not to lay down more obligations than those which are necessary. It includes the characteristic of a close corporation where the members are entitled to run the business. There is no distinction similar to the distinction made between directors and shareholders in a private company (Symington 1986:2). This means that the close corporation is both owned and managed by its members, and can thus be classified as an owner-managed entity (Van Dorsten 1991:25).

A further simplification embodied in requirements for close corporations is that no matters are specified for disclosure, as there is no equivalent to the Schedule 4 of the Companies Act (Everingham & Kana 2004:249). The source of disclosure requirements for close corporations is Section 58 of the Close Corporations Act, which requires annual financial statements to be prepared in conformity with generally accepted accounting practice suitable to the business of the corporation. The Act further requires fair presentation as an overriding requirement with the emphasis placed on providing an assessment of the net worth and solvency of the corporation concerned (Everingham & Kana 2000:3).

SAICA elucidates these requirements in its revised "Guide on Close Corporations", published in December 2001. In this guide it is no longer recommended that close corporations comply with the Statements of GAAP. Instead, the guide states that, in determining what is generally accepted accounting practice appropriate to the business of the corporation, the preparer of the annual financial statements should have regard to the needs of the members of the close corporation. It is further stated that in deciding what is "appropriate to the business", consideration should be given to the trading and operating activities of the corporation and the generally accepted accounting practices of the environment in which the corporation operates (SAICA 2001:22).

However, these requirements are still too vague to be put into practice. Accordingly, there is a wide support among members of SAICA for the development of simpler reporting standards for small enterprises in SA. The Board of SAICA approved in principle of such a move. The Accounting Practices Committee (APC) of SAICA and representatives of SARS, the South African Chamber of Business, the Banking Council of South Africa, the Institute of Directors and large and small practices confirmed their support. This resulted in the issue of DP 16, "Limited Purpose Financial Statements - A Discussion Draft", by

SAICA in May 2000, setting out the proposed reduced disclosure requirements for differential reporting purposes (Prinsloo 2000:2).

However, DP 16 was not accepted as the ideal solution. It is believed that the reduction of specific disclosures was not substantial enough to have a significant effect on the compliance with GAAP (Cleminson & Rabin 2002:336). This discontentment with DP16 resulted in the establishment and approval of a committee set up to develop LPFRS, by the SAICA Board in May 2002. The committee developed Exposure Draft (ED) 163 "Framework for the Preparation and Presentation of Limited Purpose Financial Statements", released in June 2003. The Framework was prepared for use by entities that qualify in terms of the Financial Reporting Bill ("The Bill") to present financial statements that comply with LPFRS (SAICA 2003:1). The identification of these qualifying entities is discussed in the following section.

4.7.1 Identifying small entities

In order to identify small entities for differential reporting purposes, the definition of LPFRS should be analysed. LPFRS are defined by the proposed "Financial Reporting Act" as "Financial reporting standards set for the preparation and presentation of financial statements of an entity where (SAICA 2002:4) -

- there are no users of those financial statements of a class as contemplated in the definition of "general purpose financial reporting standards"; or
- all of the users of those financial statements as contemplated in the definition of "general purpose financial reporting standards" have waived, in accordance with a relevant act, their right to receive financial statements complying with general purpose financial reporting standards and have consented to the issuing to them of financial statements complying with limited purpose financial reporting standards; and
- the entity does not receive deposits or loans from members of the general public and the securities of the entity are not issued to members of the general public. "

In contrast, general purpose financial reporting standards are defined as "Financial reporting standards set for the preparation and presentation of the financial statements of an entity where -

- any users of the financial statements of the entity have to rely mainly or solely on those financial statements for financial information regarding the entity; or
- the entity receives deposits or loans from members of the general public or where the securities of the entity are issued to members of the general public. "

Similar to Canada, the criteria used to identify small entities for differential reporting purposes in SA, are thus qualitative and not quantitative. This is also in accordance with the conclusion reached in chapter 3, namely that the users of the financial statements, and not the size of an entity, should be the indicator for identifying small entities for differential reporting purposes.

Another proposal included in the Framework is that entities not required to prepare general purpose financial statements, are encouraged to prepare financial statements in conformity with LPFRS (SAICA 2003:16). This proposal implies that close corporations are also included in the Framework.

In this section qualifying entities for LPFRS are identified. The accounting and reporting requirements embodied in LPFRS are analysed in the following section.

4.7.2 Accounting requirements

LPFRS are guided by the IASB Framework and are presented as alternatives to some of the requirements of IFRS. It is believed that the adjustments should create less onerous financial reporting standards compared to IFRS (SAICA 2003:15). This belief exists despite the fact that the adjustments are mostly only related to the disclosure requirements.

The disclosure exemptions suggested in ED 163 relate to the following (SAICA 2003:6):

- business combinations;
- cash flow statements;
- consolidated financial statements;
- deferred taxation;
- discontinuing operations;
- financial instruments;
- impairment of assets;
- intangible assets;
- interests in joint ventures;
- inventories;
- investments in associates;
- leases;
- property, plant and equipment; and
- provisions.

Exemption from these disclosure requirements is permitted on the basis that the cost of meeting certain requirements will exceed the benefits attached to them. Even though it is believed that once a transaction has been accounted for in terms of the recognition and measurement requirements of LPFRS, the incremental cost of disclosure usually does not exceed the benefit, it is the opinion of the committee that for qualifying entities the cost of meeting certain of the disclosure requirements of IFRS relating to the above, will exceed the benefit attached thereto.

In the process of identifying disclosure exemptions, the goal set by the working group on differential reporting was to produce a conceptually sound approach to the ever-increasing gulf between disclosure requirements of listed enterprises and the rest. The approach adopted by the working group recognised that, because interested parties may demand information from the enterprise, it is appropriate to set a minimum level of disclosure. The interested parties are then afforded the opportunity to decide how much additional disclosure is required to meet the needs of the users of the financial statements of enterprises. Important to this scenario is the possibility that enterprises can tailor their financial statements to meet their user needs instead of producing a load of unnecessary and expensive data (Heymans 2000:31).

Even though it is mostly only disclosure requirements that were reduced, it was further suggested by the committee in ED 163 that for qualifying entities the cost of meeting certain recognition and measurement requirements of IFRS also exceeded the benefit. These relate to the following (SAICA 2003:4):

- deferred taxation; and
- financial instruments.

It is therefore proposed that LPFRS should provide for alternatives to the recognition and measurement criteria of IFRS relating to the above.

In response to the developments on LPFRS, Coetzee (2001:11) stated that accountants are endeavouring too much to please foreign investors at the expense of local businessmen wanting a more relaxed form of trading, which was the very reason for the introduction of close corporations. He stated that to enforce legal backing for compliance with accounting standards on close corporations, will defeat the whole object of moving away from private companies to close corporations in order to enhance a more informal way of doing business.

At present, further development of the LPFRS has been put on hold. It was agreed in a meeting held on 14 September 2004 by the Limited Purpose Financial Reporting Committee of SAICA, that the Committee should not develop ED163 further, as the IASB has commenced on a project to develop financial reporting standards for small and medium-sized entities, which could be adopted in SA (SAICA 2004:3). These developments by the IASB are discussed in the next section.

4.8 International Accounting Standards Board

Hattingh (2001:35) contended that the primary mission of the International Accounting Standards Committee (IASC) was to develop standards to meet the needs of capital markets. International Accounting Standards (IAS), on which Statements of GAAP are based, were also designed for enterprises who wish to produce general purpose financial statements to enable users of their financial statements to make economic decisions with regard to the enterprise. Hattingh (2001:23) further quoted that the secretariat of the IASC had stated that individual countries should modify IAS for small entities.

The IASB (2004:10) however argued that in developing International Financial Reporting Standards (IFRS), it had not indicated that its standards are designed or intended only or primarily for entities whose securities are listed for trading in public capital markets. By doing this, the IASB had followed in the footsteps of its predecessor, the IASC. The IASB realised, however, that in countries with smaller or emerging economies, IFRSs are used as national GAAP for all or many unlisted entities, resulting in SMEs being required to follow all of the requirements of IFRSs. Even though not all of those SMEs have cited difficulties in applying IFRSs, it was determined by the IASB that there are many cases in which particular standards are departed from (sometimes with and sometimes without disclosure), and that IFRSs are applied without rigorous enforcement or quality control. The IASB also found that SMEs often cite difficulties or excessive costs in applying IFRSs.

The above-mentioned realisations resulted in the identification of the need for a differential reporting principle by the IASB, but their challenge is especially difficult, because a successful approach must be adaptable across many jurisdictions (IASB 2002:2). To assist in the development process, an Intergovernmental Working Group of Experts on International Standards of Accounting and Reporting, operating under the auspices of the United Nations Conference on Trade and Development, was formed and started working towards improving accounting information that would permit SMEs to be better managed, to access finance more easily, and to permit a more accurate calculation of their taxes (IASB 2001:Webpage).

The *ad hoc* consultative group, which was formed during the seventeenth session of the Working Group, decided that the approach which best recognised the widely differing nature of SMEs and their access to accounting expertise would involve a three-tier accounting framework, including two tiers dedicated to SMEs. The three tiers proposed were the following (United Nations Trade and Development Board 2001:4):

- Level I: The most complex level, covering all entities that issue public securities or in respect of which there is significant public interest, as well as banks and financial institutions.
- Level II: Comprising significant commercial entities that issue neither public securities nor financial reports to the general public.
- Level III: Consisting of small commercial entities that are owner-managed and have few employees.

However, the group recognised that the actual definitions of each of the three tiers must rest with the national regulators who might choose to adopt the proposed system. The group has therefore sought to provide generic definitions, intended above all to serve as a guide and to indicate its thinking. These should therefore be understood as broad indicators which are not by themselves intended to be operational (United Nations Trade and Development Board 2001:4). The proposed three levels are analysed in more detail in the following sections.

4.8.1 Level I: Most complex level

This is the most complex level, and covers all entities that issue public securities or in respect of which there is significant public interest, as well as banks and financial institutions. Significant public interest would include having sufficient employees to be in the top 10 percent of employers in the country. However, there may be other ways of arriving at a definition that includes large employers in a country as a criterion. These entities are normally expected to fully meet IAS requirements (United Nations Trade and Development Board 2001:4).

4.8.2 Level II: Significant commercial entities

This level comprises significant commercial entities that issue neither public securities nor financial reports to the general public. Such entities might have shareholders who are external to management and would normally have in-house accounting expertise sufficient to track transactions and monitor credit, and have more than a few employees. Accordingly, these entities would be larger SMEs, for which many aspects of the full IAS may be beyond their needs, since they are unlikely to have transactions or situations foreseen in the more complex standards. It is preferable that these companies use a modified set of standards, based on IAS recognition and measurement criteria, but with limited disclosure requirements (United Nations Trade and Development Board 2001:4).

The *ad hoc* consultative group further elaborated on its proposal for Level II entities by following an approach in which a separate standard for smaller entities would be produced as a subset of condensed standards (United Nations Conference on Trade and Development 2001:6). They were of the opinion that the collection of abridged IAS should have a relationship to full IAS similar to that which the FRSSE has with the UK GAAP and that it should focus on as small a core set as possible to be effective and useful and to enable efficiencies to be achieved. The selection process should firstly involve identifying those standards thought unlikely to concern SMEs, and secondly it should involve identifying disclosure requirements that would not be applicable to SMEs or could be simplified (United Nations Trade and Development Board 2001:6):

Accordingly, Level II entities would be allowed full exemption from some standards and partial exemption relating to disclosure requirements from the remaining standards. It is further proposed by the consultative group that the recognition and measurement requirements as contained in full IAS should not be modified for the Level II entities.

4.8.3 Level III: Small commercial entities

This level comprises the smallest SMEs, those experiencing the most difficulty in accessing bank and trade credit. They also have difficulties in obtaining affordable accounting services of the kind they need. The typical Level III SME could be a one-person enterprise or a business with two or three people. Consequently, the accounting requirements need to take into consideration the simplicity of the business transactions, the lack of resources and the limited in-house accounting expertise and infrastructure available (United Nations Trade and Development Board 2001:10).

The *ad hoc* consultative group recommended that Level III SMEs follow a simple accruals accounting approach, broadly consistent with IAS 1, although not necessarily aimed at users other than management, tax officials, creditors and investors. The rules proposed by the *ad hoc* consultative group would not involve compliance with IAS, but would be based on the historical cost/accruals measurement approach, which is the basis of IAS and would consist of (United Nations Trade and Development Board 2001:10):

- historical cost;
- transactions accounted for when an economic event takes place (accruals);
- allocation of expenses to the accounting periods in which related income is recognized (matching); and
- no offsetting of related items.

The above-mentioned implies a system capable of recognizing trade receivables and payables as they occur, as well as the capitalization of fixed assets, use of depreciation and recognition of inventories.

However, it should be acknowledged that where a very small business enters the formal economy for the first time, even these simple requirements might pose difficulties. Consequently, the group recommended that the model should allow for further simplification to accommodate entrant businesses in using cash accounting in the initial phase, instead of accrual accounting. The rationale behind this decision was that almost all their transactions are likely to be conducted on a cash basis. This meant that newly formed businesses or new entrants to the formal economy could be allowed, exceptionally, to provide accounts on a cash basis (United Nations Trade and Development Board 2001:4).

In brief, the differential reporting principle suggested by the Intergovernmental Working Group of Experts on International Standards of Accounting and Reporting involves a three-tier accounting framework, with two levels assigned to smaller entities. This method proved that reducing only the disclosure requirements for some small entities may not be substantial enough. In order to meet the needs of the smallest entities, these entities should also be exempted from some recognition and measurement requirements.

The method of differentiation was, however, reviewed by the IASB in its Discussion Paper "Preliminary Views on Accounting Standards for SMEs". The IASB published the discussion paper on its proposals to develop a separate set of international accounting standards for SMEs in June 2004. Specific financial reporting standards for SMEs have not yet been laid down, only the preliminary views of the IASB have been published in the discussion paper, and comments from all parties concerned were awaited till 24 September 2004 (Evans 2004:Webpage). The preliminary views of the IASB on the objective, definition and accounting requirements for SMEs are summarised in the following sections.

4.8.4 Objective and definition of SMEs

The preliminary views of the IASB on the objective of the IASB Standards for SMEs are as follows (IASB 2004:18):

- to provide high quality, understandable and enforceable accounting standards suitable for SMEs globally;
- to focus on meeting the needs of users of SME financial statements;
- to be based on the same conceptual framework as IFRSs;
- to reduce the financial reporting burden on SMEs that want to use global standards; and
- to allow easy transition to full IFRSs for those SMEs that become publicly accountable or choose to switch to full IFRSs.

With regard to the definition of SMEs, the IASB proposed the following (IASB 2004:21):

- Entities should not be listed and should not have public accountability, with public accountability defined as:
  - entities where there is a high degree of outside interest in the entity from non-management investors or other stakeholders, and those stakeholders depend primarily on external financial reporting as their means of obtaining financial information about the entity; or
  - the entity has an essential public service responsibility because of the nature of its operations;
- No size test will be used;
- Assent should be obtained from all owners;
- No further distinction between small and relatively larger SMEs will be made, because the Board sees no basis for focusing only on the relatively larger non-publicly accountable entities and for stating that IASB Standards for SMEs may not be suitable for very small entities; and
- If a subsidiary, joint venture or associate of an entity with public accountability prepares financial information in accordance with full IFRSs to meet the requirements

of the parent, venturer or investor, it should comply with full IFRSs in its separate financial statements.

The above-mentioned shows that the IASB decided that non-public accountability and not a size test should be used to identify SMEs for differential reporting purposes. This is also in agreement with the method used in Canada and SA. In the next section, the preliminary accounting requirements are discussed.

4.8.5 Accounting requirements

A few accounting issues regarding the accounting standards for SMEs were identified by the IASB in its discussion paper. Their preliminary views on these issues are summarised as follows (IASB 2004:28):

- Any modifications to the concepts or principles in IFRSs must be based on the identified needs of users of financial statements of SMEs or cost-benefit analyses;
- It is likely that disclosure and presentation modifications will be justified on the basis of user needs and cost-benefit analyses. The disclosure modifications could increase or decrease the level of disclosure relative to full IFRSs;
- There would be a rebuttable presumption that no modifications would be made to the recognition and measurement principles in IFRSs. Such modifications can be justified only on the basis of user needs or cost-benefit analyses;
- Development of IASB Standards for SMEs should start by extracting the fundamental concepts from the IASB Framework and the principles and related mandatory guidance from IFRSs, including Interpretations;
- If IASB Standards for SMEs do not address a particular accounting recognition or measurement issue that is addressed in an IFRS, the entity would be required to look to that IFRS to resolve that particular issue only. The entity would continue to use IASB Standards for SMEs for the remainder of its financial reporting. Each IASB Standard for SMEs should explicitly mention the required fallback to IFRSs;

- If an IASB Standard for SMEs provides an exemption or simplification from a recognition or measurement requirement in the related IFRS, an entity that uses IASB Standards for SMEs would not be prohibited from applying the related IFRS in its entirety, while otherwise continuing to use the IASB Standards for SMEs. Optional reversion would not be permitted for only some, but not all, principles in the related IFRS; and
- IASB Standards for SMEs should be published in a separate printed volume and should follow the IAS/IFRS and Interpretation numbering system.

It can be seen from the above preliminary views that the IASB is following the same line of thought as was done by the authorities in Canada and SA with modifications to the disclosure requirements being allowed in most cases. The reasoning behind the limitation placed on modifications to recognition and measurement requirements is explained as follows by the IASB (2004:39): Different recognition principles in IASB Standards for SMEs from recognition principles in IFRSs would mean, in substance, different definitions of assets and liabilities, and related income and expenses for SMEs. This is because income and expenses are defined in terms of changes in assets and liabilities, and equity is viewed as the difference between assets and liabilities. Accordingly, what is an asset for one entity would not be an asset for a different entity, and the IASB finds such a result troublesome and illogical.

It should be noted that the above views on the accounting standards for SMEs are only preliminary and that developments are still underway. To summarise and conclude this chapter, a comparative table of all the different methods of differential reporting implemented by the above-mentioned countries is supplied. This comparison shows the difference in the criteria used to identify small entities and the differential reporting models implemented by the various countries for these entities.

4.9 Conclusion

The different methods, guidelines and standards that were developed and implemented for differential reporting purposes by different countries are discussed in detail in this chapter. A summarised comparison between the different reporting methods is presented in this section to further highlight the strengths and weaknesses inherent to each method implemented.

Table 2 : Summary of differential reporting in different countries

COUNTRY	CRITERIA	DIFFERENTIAL REPORTING MODEL	DIFFERENTIAL REPORTING METHOD
UK	Small companies as defined in companies legislation. Classified as small if a company does not exceed two of more of the following criteria: • turnover: 2,8 million; • balance sheet total: 1,4 million; • average number of employees: 50. Companies specifically excluded: • large, or medium-sized companies, groups and other entities; • public companies; • banks, building societies and insurance companies; • authorised persons under the Financial Services Act or the Investment Intermediaries Act.	Comprehensive set of simplified standards.	Financial Reporting Standard for Smaller Entities (FRSSE): • Reduction in disclosure requirements; • measurement bases are the same as, or simplification of those, in other accounting standards; • definitions and accounting treatments are consistent with the requirements of companies legislation and are the same as or a simplified version of those required by other accounting standards.
New Zealand	• no public accountability; • all of its owners are members of its governing body; or • the entity is small. Classified as small when the entity does not exceed any two of the following: • total revenue of NZ$5 million; • total assets of NZ$2,5 million; • 20 employees.	Differential reporting framework.	"Framework for Differential Reporting", which lists 3 categories of exemptions: • full exemption; • partial exemption; and • no exemption.

COUNTRY	CRITERIA	DIFFERENTIAL REPORTING MODEL	DIFFERENTIAL REPORTING METHOD
Australia	1. Non reporting entity if: • no users dependent on general purpose financial reports for information useful for decision-making; • no separation of management from ownership and few owners/shareholders; • political and economical unimportance; • financial attributes such as small in size, in terms of sales and/or assets, and a low level of debt. 2. Classified as small if the following criteria are met: • Consolidated gross operating revenue of less than Aus$10 million; • consolidated gross assets of less than Aus$5 million; • fewer than 50 employees.	Comprehensive approach: only reporting entities need to comply with mandatory accounting standards.	• Statement of Accounting Concepts: "Definition of the Reporting Entity"; • AASB 1025 "Application of the Reporting Entity Concept and Other Amendments; and • Amendments to the Corporations Act. In preparing financial reports for a non-reporting entity: • full compliance; • partial compliance; or • total non-compliance (with the exception of AASB1025) is permitted.

COUNTRY	CRITERIA	DIFFERENTIAL REPORTING MODEL	DIFFERENTIAL REPORTING METHOD
Canada	• Non-publicly accountable enterprise; and • all owners unanimously consent to differential reporting.	A combination of targeted adjustments to standards (not a separate standard) and a differential reporting framework.	Handbook Section 1300: "Differential Reporting"; and A few related amendments to the following Handbook Sections: • Section 1590, Subsidiaries; • Section 3050, Long-term Investments; • Section 3055, Interests in Joint Ventures; • Section 3240, Share Capital; • Section 3465, Income Taxes; • Section 3869, Financial Instruments; • Section 3475, Discontinued Operations; • Section 1751, Interim Financial Statements.
USA	No public accountability.	A comprehensive set of simplified standards.	Other Comprehensive Basis Of Accounting (OCBOA), usually tax or modified cash basis.

COUNTRY	CRITERIA	DIFFERENTIAL REPORTING MODEL	DIFFERENTIAL REPORTING METHOD
South Africa	• no users that have to rely mainly or solely on financial statements for financial information regarding the entity; or • all of those users have waived their right to receive general purpose financial statements; and • the entity does not receive deposits or loans from members of the general public and the securities of the entity are not issued to members of the general public.	Targeted adjustments to standards, but as a separate standard.	"Limited Purpose Financial Reporting Standards" (LPFRS) (still under development): • reduction in disclosure requirements; • maintenance of recognition and measurement standards, except for: ➢ Deferred taxation; and ➢ financial instruments.
IASB (preliminary views)	No pubic accountability; and assent should be obtained from all owners	Targeted adjustments to standards, but as a separate standard.	Accounting standard for SMEs with allowed modifications mostly to the disclosure requirements

It can be seen from the above that the criteria used to identify small entities are a combination of qualitative and quantitative criteria, with some countries opting for either one or the other, while the remainder use a combination of qualitative and quantitative criteria. It can also be seen that the differential reporting methods implemented by the different countries vary, with some only minimising disclosure requirements, while others also developed differential recognition and measurement requirements, or exempted qualifying entities in full from some reporting standards. The strengths and weaknesses emanating from the above comparison of the different differential reporting methods should be taken into consideration in the development of a differential reporting standard in SA. In the next chapter the results of the empirical research study are analysed.

CHAPTER 5

VIEWS OF MEMBERS, CFAS, BANKERS AND SARS

5.1 Introduction

It was concluded from the previous chapters that financial reporting revolves around the information needs of the users of financial statements. Accordingly, the users of financial statements should play an important role in the development process of differential financial reporting standards for close corporations.

It was further concluded that the members of close corporations, their CFAs, bankers and SARS are the main user groups of the financial statements of close corporations. In order to gather information on their information needs, questionnaires were developed and distributed to these user groups. The results of this survey were analysed and are presented in the following sections.

5.2 Scope

Questionnaires were developed and distributed to the following user groups with an interest in the financial statements of close corporations in the Free State:

- Members of close corporations;
- The Commercial and Financial Accountants (CFAs) as preparers of financial statements;
- Bankers, who provide overdraft facilities and loans; and
- The South African Revenue Services (SARS).

The method used to identify the members of close corporations for this study, was scrutiny of the telephone directory of the Free State for 2001/2002 and selecting all the close corporations printed in bold under Bloemfontein. The CFAs were identified by obtaining a list of registered CFAs in Bloemfontein from the registration offices in Bloemfontein. Questionnaires were also sent to the offices of SARS in Bloemfontein, Welkom en Kimberley to be distributed to the personnel of SARS who are concerned with the tax returns of close corporations. Questionnaires were also sent to the following large banks to be distributed to the employees of these banks who are responsible for the approval of loans granted to close corporations:

- ABSA Bank;
- Standard Bank;
- First National Bank; and
- Nedbank.

A total of 299 questionnaires were distributed. A total of 54 completed questionnaires were received back and seventeen were returned as undelivered, equalling an 18% response.

The completed questionnaires were summarised and the results were analysed. These results are presented in the following sections.

5.3 Results

The results of the empirical research study are presented in the following order: Firstly, the results on the size of the close corporations, together with the objective and users of the financial statements of the close corporations are presented. This is followed by the usefulness and uses of the financial statements of close corporations, that is subdivided into managerial, credit analysis and tax assessment information. The results on the cost implications for close corporations are also presented, followed by the discussion of the results on the most preferred preparation method for the financial statements of close corporations. Finally, a short summary of the results is given.

5.3.1 Size, objective and users of the financial statements of close corporations

The first few questions included in the questionnaire distributed to the members of close corporations, relate to the size of the close corporations, namely:

- How many members does the close corporation have?
- How many of the members are involved in the day-to-day management of the business? and
- As an indicator of the size of the close corporation, please give estimates of the following attributes:
  - turnover per year;
  - total assets; and
  - number of employees.

The results are summarized in the table below:

Table 3 : Size of close corporations of members that responded

Nr	Number of members	Number of active members	Turnover per year	Total assets	Number of employees
1	5	3	R3 000 000	R1 500 000	30
2	5	3	R2 500 000	R 400 000	12
3	3	1	R2 880 000	R 200 000	24
4	2	2	R1 000 000	R 300 000	5
5	2	2	R1 700 000	R 50 000	13
6	2	1	R1 700 000	R 55 000	4
7	1	1	R1 700 000	R 300 000	15
8	1	1	R 700 000	R 300 000	10
9	1	1	R 350 000	R 150 000	0
10	1	1	R 75 000	R 2 500	0

The results show that most of the respondents are members of rather small close corporations with all or most of the members involved in the day-to-day management of the business. Accordingly, these corporations can be classified as owner-managed and it can be assumed that the members should have thorough knowledge of the financial side of the business and its activities without referring to financial statements.

The opinion of the members of close corporations and CFAs on what they see as the objective of the financial statements of close corporations was determined. The members responded as follows:

- to ascertain the profit or loss;
- to report to relevant interested parties;
- to give record of operation of the year;
- for managing and tax purposes;
- to ascertain growth over a period of time;

- to calculate leverage;
- for government regulation; and
- to keep the bank and SARS happy.

The responses of the CFAs are summarised as follows:

- comparability, understandibility and use to the owners;
- to show members' interest, i.e. net value = assets - liabilities;
- to determine the performance of the close corporation;
- to assist in the calculation of tax and the completion of tax returns;
- to provide information in an easy format, which is plain, understandable and short, but on a financially sound basis;
- to provide financial information to members;
- to look into the solvency of a close corporation;
- to provide information for financial decision-making and planning purposes; and
- to become a tool to business owners. It should, however, become more in line with actual business activities and market trends, therefore tax reform is required to meet with these compliances;
- to give a true reflection of the profits, assets and liabilities of the entity; and
- to be an accurate and fair presentation of the close corporation, although most close corporations are to small too warrant/afford correct workings and the paying of tax and VAT tends to be the main consideration of members.

Overall it can be concluded from the above-mentioned responses that the respondents identified the objective of the financial statements as to provide useful information to the users of these financial statements. This is also in agreement with conclusions reached in the previous chapters.

In order to confirm the main user groups of the financial statements of close corporations, the members of close corporations and CFAs were asked to name the users of the financial statements to whom they send a copy to. The members identified the following users:

- banks;
- other members;
- SARS;
- the credit bureau; and
- creditors.

The users identified by the CFAs are summarised as follows:

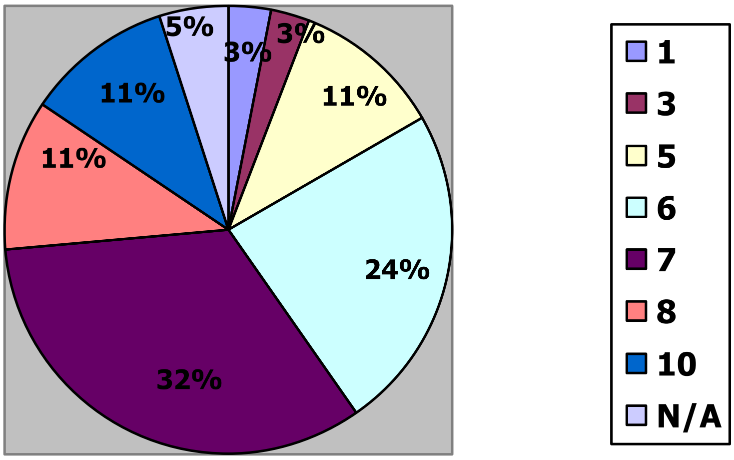
- owners;
- SARS;
- financial institutions;
- investors; and
- suppliers.

It is seen from the above responses that the users identified by the CFAs are mainly the same as those identified by the members of close corporations. The users that were mainly identified are the owners, SARS and banks/financial institutions, with creditors/credit bureau, investors and suppliers identified to a lesser extent. It can therefore be concluded that the users of the financial statements of close corporations are limited. This is in agreement with the conclusions reached in previous chapters. In the following section the results on the usefulness and uses of the financial statements of close corporations are discussed.

5.3.2 Usefulness and uses of the financial statements of close corporations

Firstly, the members of close corporations, SARS and the bankers were asked how useful they find the current form of financial statements. A scale from one to ten, with one equalling not useful and ten very useful, was given. The results are illustrated as follows:

Graph 1: Usefulness of financial statements

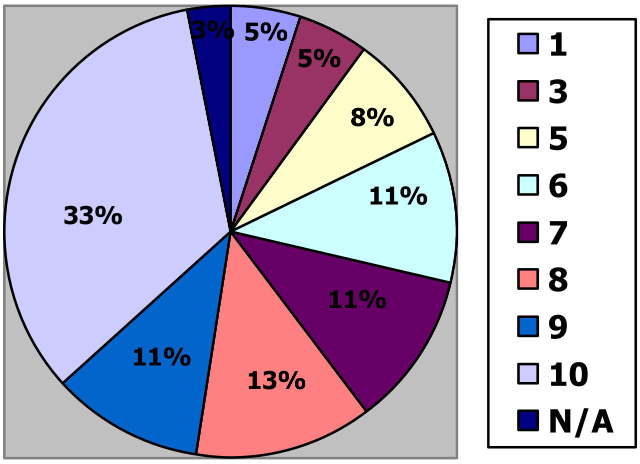


RATING	10	9	8	7	6	5	4	3	2	1	N/A
NUMBER	4	0	4	13	9	4	0	1	0	1	2
PERCENTAGE	11%	0	11%	32%	24%	11%	0	3%	0	3%	5%

The results show that 78% of the respondents regard the current form of their financial statements useful, with a rating of six and higher. This may be in contrast to the hypothesis stated in chapter one, namely that the information needs of the users of financial statements of close corporations will not be met by financial statements prepared according to the Statements of GAAP. The 5% for N/A are respondents who did not complete this question.

The members of close corporations, SARS and bankers were further asked how dependent they are on the financial statements for managerial, tax assessment and credibility information respectively. The scale from one to ten, with one representing not dependent and ten very dependent, was again given as guideline. The graph below illustrates the results:

Graph 2: Dependence for managerial, tax assessment and credibility information



RATING	**10**	**9**	**8**	**7**	**6**	**5**	**4**	**3**	**2**	**1**	**N/A**
NUMBER	13	4	5	4	4	3	0	2	0	2	1
PERCENTAGE	33%	11%	13%	11%	11%	8%	0	5%	0	5%	3%

The results show the following:

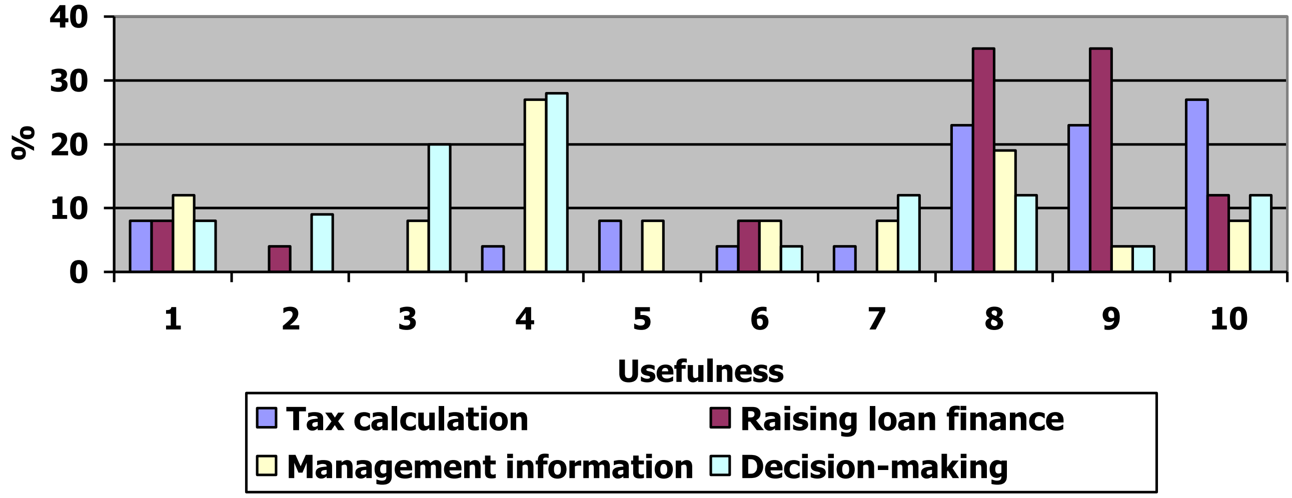
- 79% of the respondents are very dependent on their financial statements for either managerial, tax assessment or credibility information with a rating of six and higher;
- the 3% for N/A were respondents who did not complete this question;
- 8% of the respondents are indecisive with a rating of five;
- the remaining 10% of the respondents gave a rating of three and lower; and
- it is further noted that 34% of the members of close corporations that responded, replied that they are not dependent on their financial statements for managerial information, with a rating of three and lower. A reason for their independence of financial statements can be because of different accounting systems being used for record-keeping purposes, which results in either the availability or unavailability of other information for managerial purposes.

Overall it can be concluded from these results that the financial statements play an important role in providing users with managerial, tax assessment and credibility information. In order to expand on these uses of the financial statements of close corporations, the members of close corporations and CFAs were furthermore asked to rate the following uses in order of importance:

- tool for calculating taxation;
- tool for raising loan finance;
- source of management information;
- source of financial information for decision-making purposes; and
- other (please specify).

A scale form one to ten, with one equalling not important and ten very important, was given. The results are illustrated as follows:

Graph 3: Uses of financial statements



TAX CALCULATION										
RATING	**10**	**9**	**8**	**7**	**6**	**5**	**4**	**3**	**2**	**1**
NUMBER	7	6	6	1	1	2	1	0	0	2
PERCENTAGE	27%	23%	23%	4%	4%	8%	4%	0%	0%	8%
EFFECTIVE RATING	35%	27%	24%	3%	3%	5%	2%	0%	0%	1%

RAISING LOAN FINANCE										
RATING	**10**	**9**	**8**	**7**	**6**	**5**	**4**	**3**	**2**	**1**
NUMBER	3	9	9	0	2	0	0	0	1	2
PERCENTAGE	12%	35%	35%	0	8%	0	0	0	4%	8%
EFFECTIVE RATING	15%	41%	36%	0	6%	0	0	0	1%	1%
MANAGEMENT INFORMATION										
RATING	**10**	**9**	**8**	**7**	**6**	**5**	**4**	**3**	**2**	**1**
NUMBER	3	0	2	7	2	2	2	5	1	2
PERCENTAGE	12%	0	8%	27%	8%	8%	8%	19%	4%	8%
EFFECTIVE RATING	21%	0	11%	34%	8%	7%	6%	10%	1%	1%
DECISION-MAKING										
RATING	**10**	**9**	**8**	**7**	**6**	**5**	**4**	**3**	**2**	**1**
NUMBER	2	0	5	7	0	1	3	3	1	3
PERCENTAGE	8%	0%	20%	28%	0	4%	12%	12%	4%	12%
EFFECTIVE RATING	14%	0	29%	35%	0	4%	9%	6%	1%	2%

The results show that 90% of the respondents regard raising loan finance, and 81% of the respondents regard the calculation of tax, as very important uses of financial statements, with a rating of six and higher. It is also clear from the above that 56% of the respondents also regard decision-making, and 55% of the respondents regard the provision of management information, as important uses of the financial statements, with a rating of six and higher. Accordingly, all four uses are regarded as important by the CFAs and the members of close corporations, with the main uses identified as the raising of loan finance and calculation of tax. This is in agreement with the discussions conducted in previous chapters. In the next section, the use of financial statements to provide management information is elaborated further.

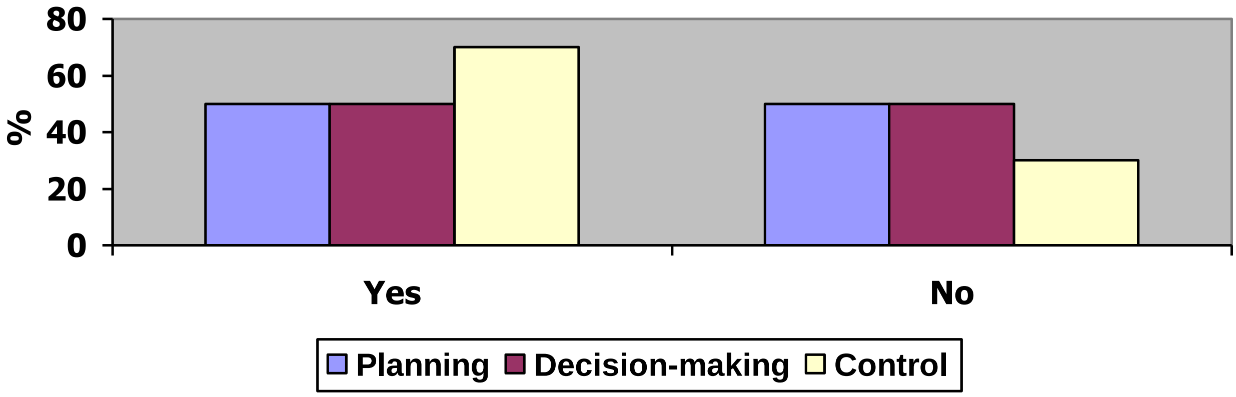
5.3.3 Managerial information

In order to expand on the managerial information, the members of close corporations were asked if their financial statements provide them with useful information for:

- planning;
- decision-making; and
- control.

They were also asked to specify the information that they either do or do not find useful. The results are illustrated by the graph below:

Graph 4: Useful information



The results show that an equal number of the members that responded, replied that their financial statements provide them with either useful or not useful information for planning and decision-making purposes. This can again be a result of different accounting systems being used. However, the majority of respondents replied that the financial statements do not provide them with useful information for exercising control.

Some of the useful information that was specified by the members, can be summarised as follows:

- cost and production information for explanation purposes;
- cost centre information;
- cash flow and statements for expenses/income;

- dividing the statements into the different sections to determine areas that do not perform; and
- budget & sales.

This specified information is, however, supplementary and not normally disclosed in financial statements. It can therefore be concluded that the financial statements are already tailored according to the information needs of the members.

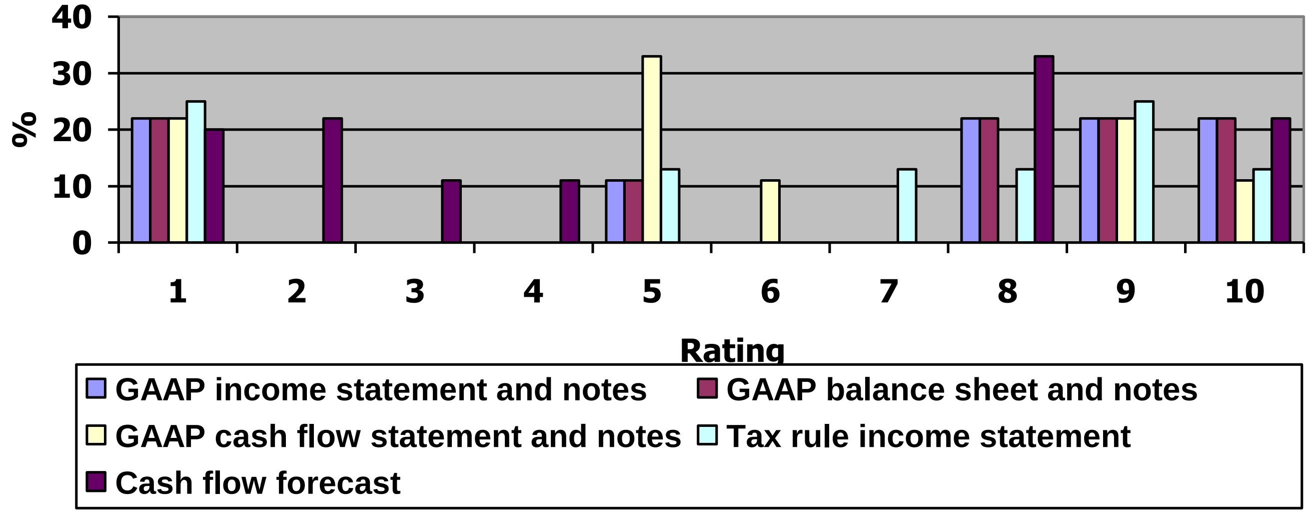
On the other hand, some of the respondents replied that they do not use financial statements at all. The reason they gave is that the financial statements are received much too late to be worth anything. This explains why some respondents do not find the current form of financial statements useful.

Still on the topic of managerial information, the members of close corporations were also asked to rate the following sources of managerial information in order of importance with one equaling the least important for managerial information, and ten the most important:

- income statement and notes prepared according to GAAP;
- balance sheet and notes prepared according to GAAP;
- cash flow statement and notes prepared according to GAAP;
- income statement prepared according to tax rules;
- cash flow forecasts; and
- other.

The results are illustrated in the graph below:

Graph 5: Sources of managerial information



GAAP INCOME STATEMENT AND NOTES										
RATING	**10**	**9**	**8**	**7**	**6**	**5**	**4**	**3**	**2**	**1**
PERCENTAGE	22%	22%	22%	0	0	11%	0	0	0	22%
EFFECTIVE RATING	33%	30%	26%	0	0	8%	0	0	0	3%

GAAP CASH FLOW STATEMENTS AND NOTES										
RATING	**10**	**9**	**8**	**7**	**6**	**5**	**4**	**3**	**2**	**1**
PERCENTAGE	11%	22%	0	0	11%	33%	0	0	0	22%
EFFECTIVE RATING	20%	35%	0	0	12%	29%	0	0	0	4%
GAAP BALANCE SHEET										
RATING	**10**	**9**	**8**	**7**	**6**	**5**	**4**	**3**	**2**	**1**
PERCENTAGE	22%	22%	22%	0	0	11%	0	0	0	22%
EFFECTIVE RATING	33%	30%	26%	0	0	8%	0	0	0	3%
TAX RULE INCOME STATEMENT										
RATING	**10**	**9**	**8**	**7**	**6**	**5**	**4**	**3**	**2**	**1**
PERCENTAGE	13%	25%	13%	13%	0	13%	0	0	0	25%
EFFECTIVE RATING	20%	36%	16%	14%	0	10%	0	0	0	4%
CASH FLOW FORECAST										
RATING	**10**	**9**	**8**	**7**	**6**	**5**	**4**	**3**	**2**	**1**
PERCENTAGE	22%	0	33%	0	0	0	0	11%	11%	22%
EFFECTIVE RATING	39%	0	47%	0	0	0	0	6%	4%	4%

The results show the following:

- 66% of the respondents replied that the income statement, balance sheet and notes prepared according to GAAP are important sources of managerial information, with ratings of eight and higher, and another 11% are indecisive with a rating of five;
- 55% of the respondents replied that cash flow forecasts are an important source of managerial information, also with a rating of eight and higher;
- 64% of the respondents replied that the income statement prepared according to tax rules are an important source of managerial information, with a rating of seven and higher and another 13% are indecisive with a rating of five; and
- only 44% of the respondents regard the cash flow statement and notes prepared according to GAAP as an important source of managerial information, with a rating of six and higher and another 33% are indecisive with a rating of five.

Accordingly, it can be concluded that the cash flow statements and notes prepared according to GAAP are not regarded as an important source of managerial information by the members of close corporations. Furthermore, the members of close corporations are indecisive regarding the importance of the other sources of managerial information with almost an equal number of respondents rating the sources of managerial information either as important or not important.

Still on a managerial viewpoint, the members of close corporations and CFAs were asked to identify the most important source of information when an acquisition/sale of an ownership interest in the close corporation occurs, from the following options:

- financial statements;
- other information; or
- both.

They were also asked to specify the other information where applicable.

According to 70% of the members that responded, both the financial statements and other information are used when an acquisition/sale occurs. The following other information was specified:

- market trends;
- bank statements;
- invoice/cash sales;
- history in terms of capital growth/tax;
- day-to-day turnover trends; and
- monthly income statements prepared by the member itself.

In agreement with the members of close corporations, a majority of 44% of the CFAs that responded, replied that both the financial statements and other information are important sources of information when a sale/acquisition of membership occurs. However, 38% of the respondents replied that financial statements are the most important source of information, while 19% of the respondents opted for the other information. The following is the other information specified by the respondents:

- what the purchase price consists of;
- equity and loan information;
- statutory documents;
- location;
- type of business;
- the members of the close corporation;
- cash flow projections;
- business plans;
- valuations based on previous financial statements;
- future projected cash flow and price earnings of similar companies;
- details of asset valuation and earning potential;
- marked trends - competition, etc;
- calculation of goodwill;
- calculation of members' interest valuation; and

- the "real figures"

It can be concluded from the above results that the financial statements are not the most important source of information when an acquisition or sale of ownership interest occurs. Additional information about the close corporation not contained in the financial statements, even if prepared according to the Statements of GAAP, is also important for decision-making purposes.

In conclusion, the last few questions illustrated the importance of the financial statements as a tool to provide users with managerial information. The results show that the members of close corporations are indecisive regarding the importance of financial statements as a tool to provide users with managerial information. Some members replied that they regard the financial statements as an important tool to provide them with managerial information for planning and decision-making purposes, while others responded that they do not use the financial statements at all. In the following section the importance of the financial statements as a tool to provide users with credibility information is discussed.

5.3.4 Credibility information

The bankers were asked whether the financial statements of close corporations provide them with useful information for credit analysis purposes and to specify the information they find useful. All the respondents replied that the financial statements of close corporations provide them with useful information for credit analysis purposes. Their specifications are summarised as follows:

- description of fixed assets, i.e. types and structure;
- types and structure of liabilities to determine how much outside debt the client has, i.e. at other financial institutions;
- contingent liabilities;

- bankers' details;
- confirmation of drawings and the capital account, i.e. how much money flows back into the business;
- members' loans;
- solvency, liquidity and gearing ratios;
- cash flow information by looking at the debtors and creditors' lists and the time it takes the client to pay his creditors and to collect his money from his debtors;
- repayment ability of the client;
- turnover and expenditure of the close corporation;
- comparison of turnover and profits on a year-to-year basis;
- trends that can be picked up; and
- the balance sheet in general.

It can be concluded from the above responses that compliance with the full Statements of GAAP in the financial statements of close corporations is not necessarily a requirement to present this useful information in the financial statements of close corporations. It is also further believed that bankers can, and will, request for additional information when needed. Accordingly, the bankers were asked in the questionnaire if they request additional information to supplement the financial statements, and if so, to specify the additional information requested.

Surprisingly, only 57% of the respondents from banks replied that they request additional information to supplement the financial statements. Their specifications can be summarised as follows:

- asset register;
- debtors and creditors' lists and analysis;
- cash flow projections for a year;
- management accounts;
- assets and liabilities of the members of the close corporation in their personal capacity;
- available security that members can offer;
- documents of changes in members; and

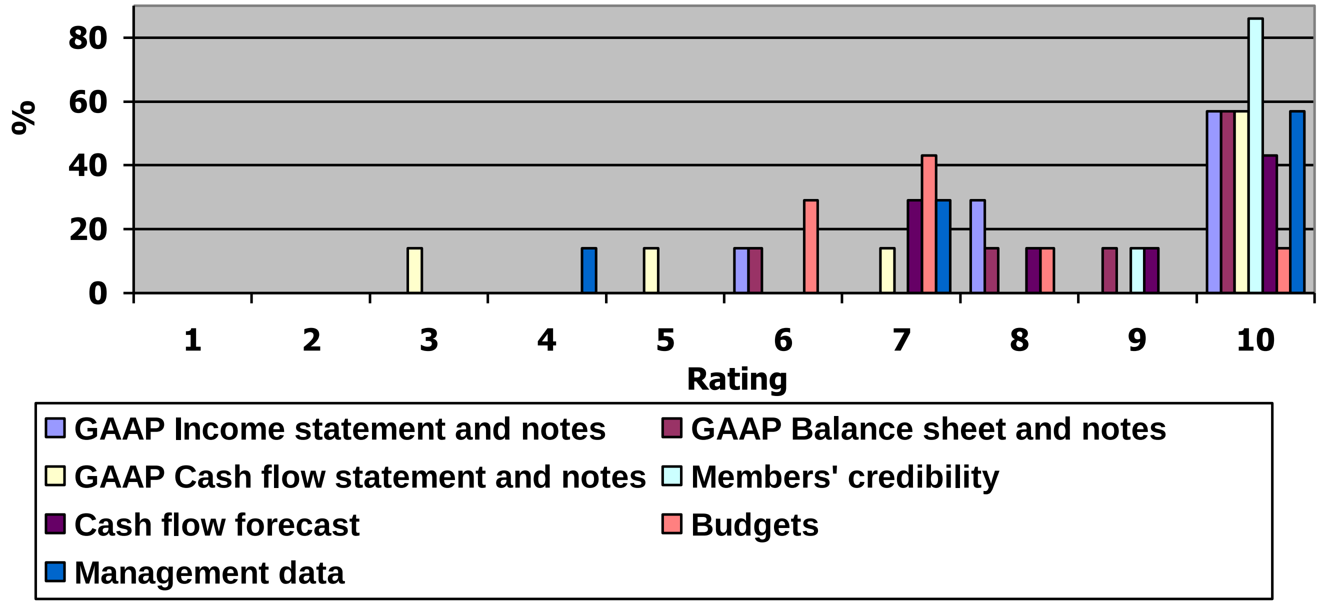
- credit bureau checks on the close corporation and the members.

It can be concluded form the above results that even if the financial statements are compiled using the full set of Statements of GAAP, bankers will still have to request the additional information to meet their information needs. Furthermore, to identify the most important sources of credibility information, the bankers were asked to rate the following sources of credibility information in order of importance, with one equalling the least important for credibility information, and ten the most important:

- income statement and notes prepared according to GAAP;
- balance sheet and notes prepared according to GAAP;
- cash flow statement and notes prepared according to GAAP;
- members' credibility;
- cash flow forecasts;
- budgets;
- management data; and
- other (please specify)

The results are summarised as follows:

Graph 6: Sources of credibility information



GAAP INCOME STATEMENT AND NOTES										
RATING	**10**	**9**	**8**	**7**	**6**	**5**	**4**	**3**	**2**	**1**
PERCENTAGE	57%	0	29%	0	14%	0	0	0	0	0
EFFECTIVE RATING	65%	0	26%	0	10%	0	0	0	0	0
GAAP BALANCE SHEET AND NOTES										
RATING	**10**	**9**	**8**	**7**	**6**	**5**	**4**	**3**	**2**	**1**
PERCENTAGE	57%	14%	14%	0	14%	0	0	0	0	0
EFFECTIVE RATING	63%	14%	13%	0	10%	0	0	0	0	0
GAAP CASH FLOW STATEMENT AND NOTES										
RATING	**10**	**9**	**8**	**7**	**6**	**5**	**4**	**3**	**2**	**1**
PERCENTAGE	57%	0	0	14%	0	14%	0	14%	0	0
EFFECTIVE RATING	73%	0	0	13%	0	9%	0	5%	0	0
MEMBERS' CREDIBILITY										
RATING	**10**	**9**	**8**	**7**	**6**	**5**	**4**	**3**	**2**	**1**
PERCENTAGE	86%	14%	0	0	0	0	0	0	0	0
EFFECTIVE RATING	87%	13%	0	0	0	0	0	0	0	0
CASH FLOW FORECAST										
RATING	**10**	**9**	**8**	**7**	**6**	**5**	**4**	**3**	**2**	**1**
PERCENTAGE	43%	14%	14%	29%	0	0	0	0	0	0

EFFECTIVE RATING	49%	15%	13%	23%	0	0	0	0	0	0
BUDGETS										
RATING	**10**	**9**	**8**	**7**	**6**	**5**	**4**	**3**	**2**	**1**
PERCENTAGE	14%	0	14%	43%	29%	0	0	0	0	0
EFFECTIVE RATING	20%	0	16%	41%	24%	0	0	0	0	0
MANAGEMENT DATA										
RATING	**10**	**9**	**8**	**7**	**6**	**5**	**4**	**3**	**2**	**1**
PERCENTAGE	57%	0	0	29%	0	0	14%	0	0	0
EFFECTIVE RATING	69%	0	0	24%	0	0	7%	0	0	0

The results show that all of the above sources of credibility information are regarded as important by the respondents. It is again noted that the cash flow statement and notes prepared according to GAAP are, compared to the other sources, regarded as the least important sources of credibility information, with only 71% of the respondents rating it at six and higher. This is also in agreement with the responses received from the members of close corporations.

In conclusion, it can be seen from the above results that the bankers regard the financial statements of close corporations as an important tool to provide users with credibility information, even though they are in a position to request additional information from close corporations. It was further determined that the information needs of bankers are specific and that the compliance with the full Statements of GAAP in the financial statements of close corporations is not necessarily a requirement to present useful information in the financial statements of close corporations to bankers. In the following paragraphs the importance of financial statements as a tool to provide users with tax assessment information is discussed.

5.3.5 Tax assessment information

The personnel of SARS were asked if the financial statements provide them with useful information for tax assessment purposes, and to specify the information they find useful. In agreement with the responses of the bankers, 86% of the respondents replied that the financial statements provide them with useful information for tax assessment purposes.

They specified the following useful information:

- income and expenses;
- fixed assets and current assets;
- long-term liabilities and current liabilities;
- stock on hand;
- members' loan accounts;
- depreciation schedules;
- interests and remuneration paid to members;
- salaries paid;
- cash flow statement;
- income statement with notes;
- balance sheet with notes;
- tax calculation;
- ability to establish the capital of close corporation via the assets and liabilities;
- declaration of "dividends" and also the declaration of STC; and
- further information for tax purposes like the names of members and members' fees paid.

Some of the respondents further elaborated on the above responses with the declaration that they assume that the financial statements are reliable, as the statements have to be drawn up by an accounting officer, who, according to them, laid down an oath that the financial statements will be accurate, correct and precise. One of the respondents further replied that the details required for tax assessment purposes are mostly a derivative from

the financial statements which are validated by the accounting officer, but that the detailed income statements are usually not covered by any such reports, resulting in the credibility being not definitely certain. Therefore it can be concluded from these responses that the credibility of the information in the financial statements of close corporations is highly valued by the employees of SARS.
Other information identified by the employees of SARS as being regarded as important, but not disclosed in the financial statements of close corporations, are the tax reference numbers of members. This shows that even if all the information required by the Statements of GAAP is disclosed in the financial statements of close corporations, it will not meet all of the information needs of the personnel of SARS, resulting in the possibility of the requisition of additional information. Accordingly, personnel of SARS were asked whether they request additional information to supplement the financial statements, and if they replied in the affirmative, to specify the additional information requested.

According to 52% of the respondents, they request additional information. The information specified is the following:

- trial balance;
- general ledger;
- debtors and creditors' list;
- list of inventory at the year end;
- fixed asset register;
- bank reconciliation;
- a full analysis of the loan accounts of members;
- sales invoices;
- purchase invoices;
- the salaries and wages register and all other relevant information regarding salaries, i.e. PAYE with fringe benefit details;
- bad debt with reasons;
- VAT working papers;

- analysis of detailed expense and revenue accounts, as well as documentation to support the entries, are usually requested in return but not always supplied; and
- where the close corporation has another year end than the members, a reconciliation is needed between the figure accrued to the member till 28/02 and the amount applicable to the other period.

It can be concluded from the above results that, regardless of compliance with all the requirements of the Statements of GAAP in the financial statements of close corporations, an amount of additional information will still be requested by the personnel of SARS to fulfil their specific information needs. The main reason for this is the difference between accounting and tax rules.

To summarize, the above results show that the personnel of SARS regard financial statements as an important tool to provide them with tax assessment information and that the credibility of the information contained in the financial statements is regarded as important by them. It was further seen that the information needs of the personnel of SARS are specific and that compliance with the full Statements of GAAP in the financial statements of close corporations is not necessarily a requirement for presenting useful information to the personnel of SARS. Furthermore, in agreement with the bankers, the personnel of SARS are also in a position to request additional information when required.

Overall it can be concluded from the above discussions that the users of the financial statements of close corporations regard the financial statements as an important tool in providing them with useful information. In the following section the cost vs. benefits constraint on the disclosure of information in the financial statements of close corporations is discussed.

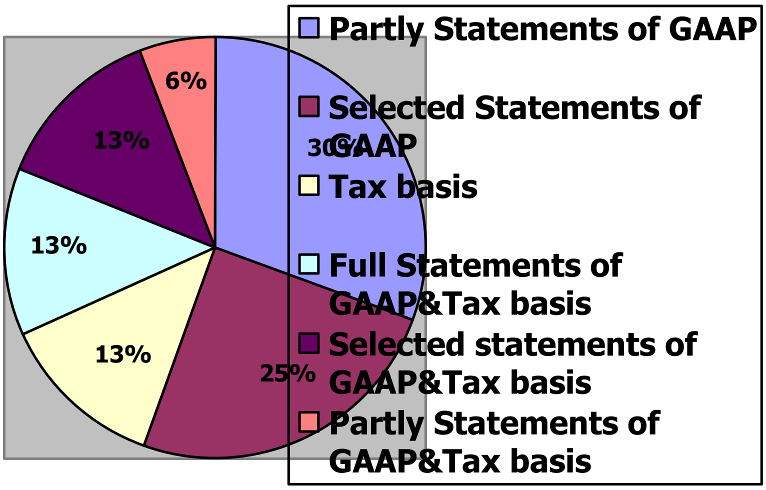
5.3.6 Cost vs. benefits

The members of close corporations and the CFAs were asked if the costs of the financial statements of close corporations, according to them, exceed the benefits derived from the financial statements. According to 70% of the members of close corporations that responded, the costs of their financial statements exceed the benefits they derive from these statements. This result is in agreement with the hypothesis stated in chapter one. According to only 56% of the CFAs that responded, the costs exceed the benefits. This surprisingly small majority may be due to CFAs no longer using the full set of Statements of GAAP when compiling the financial statements of close corporations. This is confirmed by responses to the following question, where the CFAs were asked what basis they currently use in the preparation of financial statements for close corporations, and they had to choose from the following options:

- full statements of GAAP (all measurement, recognition and disclosure requirements);
- partly statements of GAAP (all measurement and recognition, but less disclosure requirements);
- selected statements of GAAP (selected measurement, recognition and disclosure requirements);
- tax basis (full compliance with tax rules);
- cash basis (when cash is received or paid); or
- other (please specify)

The results are illustrated as follows:

Graph 7: Basis of preparation



	PARTLY STATEMENTS OF GAAP	SELECTED STATEMENTS OF GAAP	TAX BASIS	FULL STATEMENTS OF GAAP & TAX BASIS	SELECTED STATEMENTS OF GAAP & TAX BASIS	PARTLY STATEMENTS OF GAAP & TAX BASIS
NUMBER	5	4	2	2	2	1
PERCENTAGE	30%	25%	13%	13%	13%	6%

It can be concluded from the above results that in most cases CFAs partly use Statements of GAAP to prepare the financial statements of close corporations, i.e. all measurement and recognition requirements contained in the Statements of GAAP, but with less disclosure, or selected Statements of GAAP, i.e. selected measurement, recognition and disclosure requirements. These results confirm that the financial statements concerned are already tailored according to the information needs of the users.

In respect of non-compliance with the Statements of GAAP, the personnel of SARS and banks were asked if non-compliance with the Statements of GAAP in the financial statements of close corporations will influence the tax assessing process and the decision of providing loan facilities to close corporations, respectively. They were further asked to specify the influence non-compliance would have on their decisions in this regard.

According to 71% of the bankers that responded, non-compliance will influence their decision on the advancement of loan facilities to close corporations. They specified non-credibility of the financial statements as the overall concern. This is in agreement with discussions in previous chapters.

However, in contrast with the above result, 62% of the personnel of SARS that responded, replied that the tax-assessing process will not be influenced by non-compliance of the financial statements of close corporations with the Statements of GAAP. Some respondents further elaborated that this will be the case, provided that the required information for tax purposes is available. This further implies that additional information may be requested when non-GAAP financial statements are presented for tax assessment purposes. The compilation of the additional information requested can result in additional costs for the close corporation.

On the other hand, those respondents that replied that the tax-assessing process will be influenced, specified the following implications:

- more physical audits will have to be conducted;
- income can be understated and expenses overstated;
- the financial statements will not up to standard, resulting in the amount of queries to increase;
- some important information may not be shown as the accountants will only declare what they like; and
- there will be no standard set for the format of financial statements.

Accordingly, the credibility of the financial information is also questioned by the employees of the SARS when some other basis than the Statements of GAAP is proposed as preparation method for the financial statements of close corporations. The importance of the credibility of the financial statements is further confirmed by the results of the next question where the bankers were asked if the presentation of non-GAAP financial statements will influence the interest rates or other bank charges when providing a loan or overdraft facilities to close corporations, and if so, to specify.

According to 57% of the bankers that responded, interest rates and/or bank charges will not be influenced by the presentation of non-GAAP financial statements. Those respondents that replied that interest rates and/or bank charges will be influenced by the presentation of non-GAAP financial statements, specified the following reasons:

- In the banking sector interest rates are influenced by a number of factors, for example:
  - the amount of security offered;
  - a long relationship with the bank; and
  - how the client manages his accounts.
- If the clients' financial statements are good, a lower interest rate will be considered; and
- Interest rate and bank charges are risk-related.

It can therefore be concluded that there may be additional indirect costs involved if the financial statements of close corporations are compiled not using the Statements of GAAP. The reason for this is the assumed higher risks involved in the presentation of non-GAAP financial statements. This is in agreement with discussions in previous chapters and should be kept in mind in the development of a separate differential reporting standard for close corporations.

Still on the topic of cost, the CFAs were asked whether they agree that compliance with statements of GAAP is a price to be paid for limited liability by close corporations. Surprisingly, 68.75% of the respondents replied that compliance with the Statements of GAAP is a price to be paid for limited liability. This is in contrast with the results on the most useful preparation method for the financial statements of close corporations as identified by the CFAs. This issue is discussed in the next section.

5.3.7 Preparation method

The CFAs and members of close corporations were asked whether they believe that close corporations should have their own separate set of accounting standards to comply with. Only 40% of the members that responded replied that close corporations should have a separate set of accounting standards. The reason for this result can be the fact that the financial statements are already tailored to meet the needs of the members, as was seen from previous results.

In contrast to the response of the members, and also in spite of the majority that previously replied that compliance with the Statements of GAAP is a price to be paid for limited liability, 81% of the CFAs that responded replied that close corporations should have a separate set of accounting standards. To elaborate on this, the CFAs were further asked whether this separate set of accounting standards should be:

- a separate accounting standard for smaller entities; or
- differential reporting listed in each statement

Astoundingly, 75% of the respondents prefer a separate accounting standard for smaller entities above the differential reporting listed in each statement. As discussed previously, the differential reporting method may cause more work than it saves, because of the changing nature of financial reporting standards. Nevertheless, this is also the method used by SAICA in the LPFRS and UK in the FRSSE, and is also preferred by the IASB in their preliminary views on Accounting Standards for SMEs.

In order to identify the most critical standards for the separate accounting standard for close corporations, the CFAs were furthermore asked if there are some critical accounting standards to which close corporations should confirm. According to 81% of the respondents there are critical standards to which close corporations should confirm.

The CFAs were also asked to rate the individual accounting standards on a scale from one to ten, with one equalling the least critical and ten the most critical. The following table summarises the results:

Table 4: Critical accounting standards

Statement	**Rating**											
	1	**2**	**3**	**4**	**5**	**6**	**7**	**8**	**9**	**10**	**N/A**	**6-10**
AC111	0%	0%	0%	0%	0%	0%	25%	25%	13%	19%	19%	**81%**
AC102	0%	0%	0%	0%	13%	0%	6%	25%	31%	13%	13%	**75%**
AC108	0%	0%	0%	0%	6%	6%	25%	19%	13%	13%	19%	**75%**
AC123	0%	0%	0%	0%	6%	0%	6%	31%	19%	19%	19%	**75%**
AC135	0%	0%	0%	0%	0%	6%	38%	6%	13%	6%	31%	**69%**
AC000	0%	0%	13%	13%	0%	0%	6%	19%	13%	25%	13%	**63%**
AC101	0%	0%	0%	13%	6%	0%	13%	13%	19%	19%	19%	**63%**
AC107	6%	0%	0%	0%	13%	6%	25%	13%	6%	13%	19%	**63%**
AC105	0%	0%	6%	0%	19%	6%	6%	13%	25%	6%	19%	**56%**
AC114	0%	0%	0%	0%	13%	6%	13%	13%	19%	6%	31%	**56%**
AC128	6%	0%	0%	6%	13%	19%	6%	19%	6%	6%	19%	**56%**
AC129	0%	0%	0%	13%	13%	19%	13%	13%	6%	6%	19%	**56%**
AC137	0%	0%	6%	6%	0%	13%	6%	13%	19%	6%	31%	**56%**
AC130	0%	6%	6%	6%	13%	13%	6%	19%	6%	6%	19%	**50%**
AC100	0%	0%	13%	13%	13%	6%	13%	6%	0%	19%	19%	**44%**
AC103	0%	6%	0%	6%	13%	6%	25%	6%	6%	0%	31%	**44%**
AC125	13%	0%	6%	0%	6%	6%	13%	13%	6%	6%	31%	**44%**
AC134	0%	6%	6%	6%	6%	19%	6%	6%	13%	0%	31%	**44%**
AC109	0%	0%	13%	0%	19%	6%	6%	13%	0%	13%	31%	**38%**
AC110	0%	13%	6%	0%	13%	19%	13%	0%	6%	0%	31%	**38%**
AC112	0%	6%	19%	0%	6%	13%	6%	13%	0%	6%	31%	**38%**
AC117	13%	0%	6%	0%	13%	13%	19%	0%	6%	0%	31%	**38%**
AC118	13%	13%	13%	6%	0%	6%	6%	6%	6%	13%	19%	**38%**
AC119	6%	0%	6%	0%	19%	6%	25%	0%	6%	0%	31%	**38%**
AC127	25%	0%	0%	0%	6%	19%	6%	13%	0%	0%	31%	**38%**
AC133	6%	0%	6%	6%	13%	13%	13%	6%	6%	0%	31%	**38%**

AC116	13%	0%	6%	6%	13%	6%	13%	13%	0%	0%	31%	**31%**
AC115	19%	0%	13%	0%	13%	19%	6%	0%	0%	0%	31%	**25%**
AC124	25%	0%	19%	0%	0%	6%	13%	0%	6%	0%	31%	**25%**
AC126	0%	0%	13%	6%	25%	19%	0%	6%	0%	0%	31%	**25%**
AC131	13%	0%	0%	19%	13%	6%	13%	6%	0%	0%	31%	**25%**
AC132	13%	6%	19%	0%	6%	19%	0%	0%	0%	6%	31%	**25%**
AC104	13%	19%	25%	0%	13%	6%	0%	6%	0%	0%	19%	**13%**

The results show that the following standards are regarded by the CFAs as being the most critical accounting statements in the preparation of the financial statements of close corporations, with more than 50% of the respondents rating it at six and higher:

- AC111 Revenue;
- AC102 Income Tax;
- AC108 Inventories;
- AC123 Property, plant and equipment;
- AC135 Investment properties.
- AC000 Framework for the preparation and presentation of financial statements;
- AC101 Presentation of financial statements;
- AC107 Events after the balance sheet date;
- AC105 Leases;
- AC114 Borrowing costs;
- AC128 Impairment of assets;
- AC129 Intangible assets; and
- AC137 Agriculture.

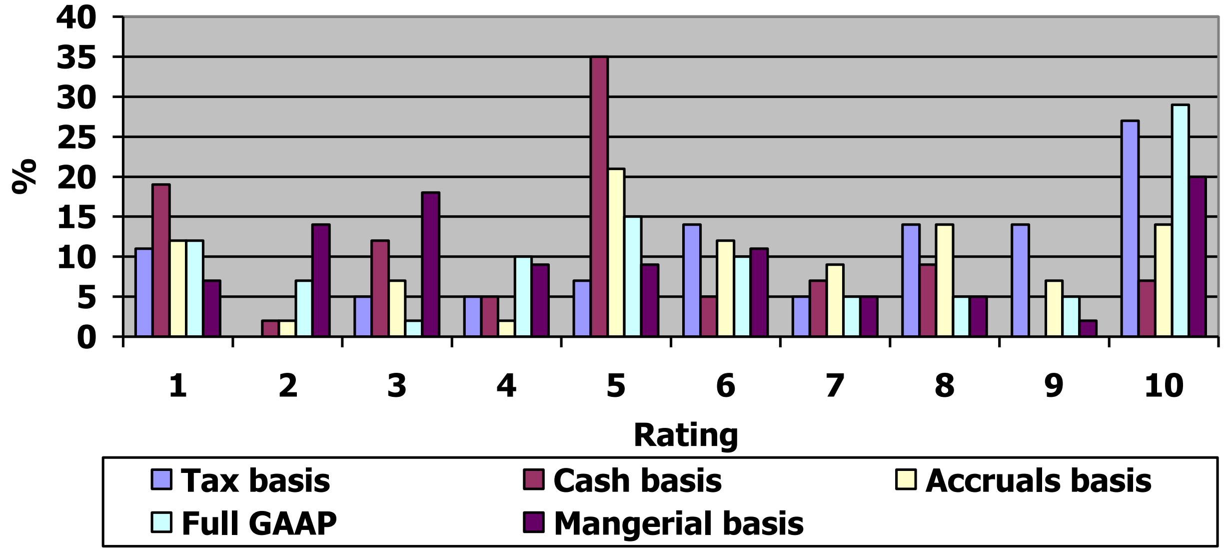
The above-mentioned standards are also those that will mostly be affected by the transactions of close corporations. In order to further identify the most preferred preparation method, all four user groups were asked to rate the following preparation methods for the financial statements of close corporations in order of preference on a scale from one to ten, with one equalling the least useful basis, and ten the most useful basis:

- tax basis;

- cash basis;
- accruals basis;
- full GAAP;
- managerial basis; and
- other (please specify)

The results are illustrated as follows:

Graph 8: Preparation method



TAX BASIS										
RATING	**10**	**9**	**8**	**7**	**6**	**5**	**4**	**3**	**2**	**1**
PERCENTAGE	27%	14%	14%	5%	14%	7%	5%	5%	0	11%
EFFECTIVE RATING	39%	18%	16%	5%	12%	5%	3%	2%	0	2%
FULL GAAP										
RATING	**10**	**9**	**8**	**7**	**6**	**5**	**4**	**3**	**2**	**1**
PERCENTAGE	29%	5%	5%	5%	10%	15%	10%	2%	7%	12%
EFFECTIVE RATING	48%	7%	6%	6%	10%	12%	6%	1%	2%	2%
CASH BASIS										
RATING	**10**	**9**	**8**	**7**	**6**	**5**	**4**	**3**	**2**	**1**
PERCENTAGE	7%	0	9%	7%	5%	35%	5%	12%	2%	19%
EFFECTIVE RATING	15%	0	16%	10%	6%	37%	4%	7%	1%	4%

MANAGERIAL BASIS										
RATING	**10**	**9**	**8**	**7**	**6**	**5**	**4**	**3**	**2**	**1**
PERCENTAGE	7%	14%	18%	9%	9%	11%	5%	5%	2%	20%
EFFECTIVE RATING	12%	22%	26%	11%	10%	10%	3%	2%	1%	4%
ACCRUALS BASIS										
RATING	**10**	**9**	**8**	**7**	**6**	**5**	**4**	**3**	**2**	**1**
PERCENTAGE	14%	7%	14%	9%	12%	21%	2%	7%	2%	12%
EFFECTIVE RATING	23%	10%	19%	11%	12%	17%	2%	3%	1%	2%

The results show the following:

- the tax basis is the most preferred basis with 74% of the respondents rating it at six and higher;
- the managerial basis, accruals basis and full GAAP are almost equal with respectively 57%, 56% and 54% of the respondents rating it at six and higher;
- only 28% of the respondents rated the cash basis at six and higher;
- the CFAs mostly prefer the managerial basis, with 69% of the respondents rating it at six and higher, followed by the tax basis, with 63% of the respondents rating it at six and higher;
- the CFAs least preferred full GAAP as preparation method, with only 6% of the respondents rating it at six and higher;
- in contrast to the CFAs, the bankers mostly prefer the full GAAP as preparation method with 86% of the respondents rating it at six and higher, followed by the managerial basis, with 71% of the respondents rating it at six and higher;
- not surprisingly, the personnel of SARS mostly prefer the tax basis as preparation method, with 81% of the respondents rating it at six and higher, followed by full GAAP and the accruals basis, with 62% of the respondents rating it at six and higher.

The above-mentioned results are partly in agreement with the hypothesis as stated in chapter one, namely that managerial, cash flow and tax-based information would be more useful to the users of the financial statements of close corporations. However, fair presentation as overriding requirement for the financial statements of close corporations should be kept in mind, as phrased in the problem statement in chapter one. Accordingly, the CFAs were asked if close corporations can have a different level of fair presentation than public companies. According to 81% of the respondents, close corporations can have a different level of fair presentation compared to public companies. This viewpoint supports the decision of SAICA to release close corporations of the burden of compliance with the Statements of GAAP. In the following section a brief summary of the results are given.

5.3.8 To summarize

Even though the CFAs are of opinion that compliance with the Statements of GAAP is a price to be paid for limited liability by close corporations, and that only a small majority agree that the cost of compliance exceeds the benefits close corporations derive from the financial statements, they agree that close corporations should have a separate set of accounting standards. They further prefer a separate accounting standard for smaller entities above differential reporting listed in each statement. They also prefer the managerial basis as preparation method and are of the opinion that close corporations can have a different level of fair presentation compared to public companies.

The opinion of the members is that they still find the current form of financial statements useful, because it serves as an important source of managerial information regarding planning and decision-making purposes. Even so, they further agree that the cost of compliance exceeds the benefits derived from the financial statements. It should, however, be kept in mind when evaluating the results, that it is no longer a requirement for close corporations to comply with the Statements of GAAP in their financial statements and that the financial statements may be adjusted accordingly.

In accordance with the members, bankers and SARS also find the current form of financial statements useful for credit analysis and tax assessment information respectively.

However, the majority of respondents replied that they request additional information to supplement the financial statements. It was further determined that both the bankers and SARS still prefer the Statements of GAAP as preparation method for the financial statements of close corporations because of the believed inherent credibility of the information. Accordingly, the financial statements of close corporations are regarded as an important information tool by the users thereof and the development of a formal set of differential reporting standards for close corporations can be regarded as a necessary step.

5.4 Conclusion

The hypothesis as stated in chapter one, reads as follows:
The information needs of the users of financial statements of close corporations will not be met by financial statements prepared according to the Statements of GAAP. The recognition, measurement and disclosure requirements contained in the Statements of GAAP do not give rise to cost-effective and useful information being provided to the users of financial statements of close corporations. Managerial, cash flow and tax-based information would be more useful.

In comparing the above results with the hypothesis, the following conclusions can be reached:

- Even though the financial statements of close corporations provide the users thereof with useful information for planning, decision-making, credit analysis and tax assessment purposes, the bankers and SARS still request additional information to supplement the financial statements. Furthermore, when an acquisition/sale of ownership in the close corporation occurs, information other than contained in the financial statements, is also regarded as important. Accordingly, not all the information needs of the users of the financial statements of close corporations are met by the financial statements prepared according to the Statements of GAAP.

- Most of the members of close corporations and CFAs are in agreement that the costs of the financial statements of close corporations exceed the benefits thereof. Accordingly, the recognition, measurement and disclosure requirements contained in the Statements of GAAP do not give rise to cost-effective information being provided to the users of financial statements of close corporations. It should, however, be kept in mind that the non-compliance with the Statements of GAAP in the financial statements of close corporations could give rise to additional indirect costs that should be taken into account when evaluating the cost vs. benefit equation. These costs include increased interest rates and/or bank charges as well as the costs associated with the compilation of additional information requested by the users.
- The tax basis is overall identified as the most useful preparation method by the users of the financial statements. The managerial basis is mostly preferred by the CFAs, while bankers prefer full GAAP. Accordingly, the hypothesis is only partly true in the sense that managerial and tax-based information would be more useful to only certain user groups.

It can further be concluded that even though it was identified that the CFAs already depart from the requirements of the Statements of GAAP when preparing the financial statements of close corporations, a formal set of differential reporting standards can still be regarded as necessary in order to achieve the required level of credibility in the financial statements of close corporations, as expected by both the bankers and SARS. However, more research into the topic of differential reporting standards is necessary before the finalisation of such standards. In this regard, proposals for further studies are given in the next chapter.

CHAPTER 6

SUMMARY, CONCLUSION AND RECOMMENDATIONS

6.1 Introduction

In this chapter a summary of the findings from the literature and empirical study is given with reference to the objective of the study as stated in chapter one. The overall conclusion reached on the findings is presented, and recommendations proceeding from the study and proposals for future research are also discussed.

6.2 Summary of findings

The objective of the study as stated in chapter one was as follows:

- to clarify the meaning of an annual report by investigating the broad aspects of financial reporting;
- to identify the users of the financial statements of close corporations;
- to identify their broad information needs; and
- to examine the meaning of fair presentation as overriding requirement for the financial statements of close corporations.

Information on these topics was gathered by means of literature study and an empirical research questionnaire. This information is presented in a summarised format in the following sections. Firstly, the meaning of an annual report is discussed, followed by discussions on the users of financial statements and their information needs. Thereafter the findings on fair presentation and the cost implications for close corporations are presented, followed by the findings on the method of differentiation.

6.2.1 Meaning of an annual report

It was concluded from the discussion on the nature of accounting, that the goal of accounting can be viewed as communication. This forms the basis for the objective of financial statements. It was further concluded in chapter two that the primary objective of financial statements is to provide useful information about the enterprise to the primary user groups of the financial statements, independent of the size of the entity. The following section will summarise the users of the financial statements of close corporations and their broad information needs.

6.2.2 Users and their information needs

In chapter two it was concluded that the primary user groups of the financial statements of close corporations are the following:

- the members;
- SARS; and
- banks/financial institutions.

The financial statements are used by the members of close corporations mainly for the purpose of raising loan finance and the calculation of tax. Secondary to these uses, the financial statements are also used by the members of close corporations for planning and decision-making purposes as part of managing the close corporation. It was, however, also identified that even though the majority of users find the financial statements of close corporations useful, some members replied that they do not use the financial statements at all. This contradicts the objective of financial statements which is to provide the users of financial statements with useful information, and stresses the need for simplified accounting standards for close corporations.

SARS requires information for tax assessment purposes, but also need assurance regarding the credibility of the information contained in the financial statements. It was further determined that the financial statements of close corporations provide the personnel of SARS with useful information for tax assessment purposes, but that a majority of 52% of the respondents still request additional information to suit their needs. This requisition of additional information can have cost implications for the close corporation, resulting in the need to reassess the cost vs. benefit implications for the close corporation.

Banks require information regarding the solvency and repayment ability of close corporations in support of their decision to provide loan finance. In agreement with SARS, they also need assurance regarding the credibility of the information contained in the financial statements. It was also determined that the financial statements of close corporations provide the personnel of bankers with useful information for credit analysis purposes, but that a majority of 57% of the respondents request additional information to suit their specific needs. This requisition of additional information can also have cost implications for the close corporation, as discussed in the previous paragraph.

In the next section the findings on the last objective, namely fair presentation in the financial statements of close corporations are discussed. The findings on the cost implications surrounding the financial statements of close corporations are also presented.

6.2.3 Fair presentation and the cost implications

In the literature study it was found that the concept of fair presentation is not defined, but that it implies that financial statements should be a fair presentation of the results of the close corporation. It was further found that fair presentation is usually achieved by complying with the requirements of the Statements of GAAP when compiling the financial statements. However, the empirical study found that a majority of 81% of the CFAs that responded are of the opinion that close corporations can have a different level of fair presentation compared to public companies and accordingly they currently use partly Statements of GAAP, or selected Statements of GAAP when compiling the financial statements of close corporations.

Notwithstanding departure from the requirements of the Statements of GAAP when compiling the financial statements of close corporations, it was determined that a majority of 70% of the members of close corporations, and 56% of the CFAs that responded are still of the opinion that the costs of the financial statements of close corporations exceed the benefits derived from it. This further accentuates the need for simplified accounting standards for close corporations.

It was, however, further determined that non-compliance with the Statements of GAAP in the financial statements of close corporations can influence the decision of bankers on the advancement of loan facilities to close corporations, as well as which interest rates and/or bank charges to apply. This implies that there may be an indirect cost involved when the Statements of GAAP are not complied with in the financial statements of close corporations. The reason for this being the believed inherent credibility of the information contained in financial statements when complying with the requirements of Statements of GAAP. These indirect costs should be taken into consideration during the development of simplified differential reporting standards for close corporations.

In conclusion, the above information accentuates the importance of the development of a formal set of simplified differential reporting standards for close corporations. In the next section the findings on the method of differentiation are discussed.

6.2.4 Method of differentiation

It was determined from the literature study that differential reporting developments are currently underway in SA with the development of the LPFRS. It was, however, determined that close corporations are only encouraged to prepare financial statements in conformity with LPFRS and furthermore that the modifications included in this LPFRS mainly relate to the disclosure requirements that were reduced, with only a few alternatives to the recognition and measurement criteria relating to deferred tax and financial instruments being allowed. Accordingly, these developments may not be sufficient for close corporations.

Nevertheless, in the empirical research study it was found that only 40% of the members of close corporations that responded replied that close corporations should have a separate set of accounting standards, while a majority of 81% of the CFAs that responded, agreed with the statement. It was further determined that 75% of the respondents agreed that these standards should be in the form of a separate set of accounting standards.

The most preferred preparation method for the financial statements of close corporations identified by the user groups is the tax basis, followed by the managerial basis, accruals basis and then full GAAP. It was, however, determined that the bankers still prefer the full Statements of GAAP, because of the believed inherent credibility of the information. The personnel of SARS also indicated that the credibility of the information contained in the financial statements is important to them.

Accordingly, in order to satisfy the need for credible information, a formal separate set of simplified accounting standards for close corporations that provide the information necessary to meet the needs of the users of the financial statements of close corporations as identified in section 6.2.2, that is still a fair presentation of the results of the close corporation, is necessary.

The question, however, is what the requirements contained in this simplified, differential reporting standards should be in order to provide the users of the financial statements of close corporations with useful information that is still a fair presentation of the results of the entity. It was determined in the empirical research study that the following standards are regarded by the CFAs as the most critical accounting statements in the preparation of the financial statements of close corporations:

- AC111 Revenue;
- AC102 Income Tax;
- AC108 Inventories;
- AC123 Property, plant and equipment;
- AC135 Investment properties.
- AC000 Framework for the preparation and presentation of financial statements;
- AC101 Presentation of financial statements;
- AC107 Events after the balance sheet date;
- AC105 Leases;
- AC114 Borrowing costs;
- AC128 Impairment of assets;
- AC129 Intangible assets; and
- AC137 Agriculture.

Accordingly, these standards should be considered in the development of separate, simplified differential reporting standards for close corporations. However, more research into the allowed modifications or alternatives for the recognition and measurement requirements of these standards should be undertaken in order to identify the most appropriate accounting requirements for close corporations.

6.3 Conclusion

The main user groups of the financial statements of close corporations are dependent on the financial statements for financial information, despite the fact that most of these users can request additional information when needed. Accordingly, the financial statements still play an important role in the provision of useful information to the users of the financial statements of close corporations. In order to satisfy the information needs of the users of the financial statements of close corporations, differential reporting standards for close corporations that are formal, separate and simplified are needed. The developments currently underway with the development of LPFRS is a step in the right direction, but may not be substantial enough for close corporations. More simplifications in the recognition and measurement requirements are needed.

6.4 Recommendations

It was concluded from the literature and empirical research study that the financial statements of close corporations are an important tool in providing the users of these financial statements with useful financial information. However, currently there is no clear defined reporting framework for close corporations implementing the financial reporting requirements as worded in the Close Corporation Act No. 69 of 1984, sect. 58(2b).

Accordingly, it is recommended that a formal, separate set of simplified differential reporting standards be developed for the purpose of close corporations. To be acceptable, the reporting method should meet most of the information needs of the users of the financial statements of close corporations and other small entities, and simultaneously provide cost-effective information that is a fair presentation of the results, taking into consideration the additional costs that may result from adopting differential reporting standards. Therefore, more attention should be given to the financial reporting requirements of close corporations.

6.5 Proposals for further research

It was concluded from the literature and empirical research study that close corporations should have a separate set of accounting standards, simplified for their purpose. It was further concluded that the reductions in the disclosure requirements of the Statements of GAAP, as presented in the LPFRS, are not substantial enough. Some of the recognition and measurement requirements should also be simplified. However, the decision on which requirements should be reduced or simplified and in what manner these requirements should be reduced or simplified in order to provide useful information to the users of the financial statements and still remain a fair presentation, is less clear. Accordingly, more research into the reduction or simplification of these recognition and measurement requirements is needed.

LIST OF REFERENCES

Accounting Standards Board (ASB), Exposure Draft: Statement of principles: The objective of financial statements and the qualitative characteristics of financial information, Accountancy, Volume 108, Number 1177, p99-103, 1991.

Accounting Standards Board (ASB), Big GAAP/little gaap: Standard relief for small companies, Accountancy, p11, Desember 1994.

Accounting Standards Board (ASB), Big GAAP/little gaap, FRSSE does not go far enough, Accountancy - International Edition, Volume 117, Number 1230, p14, 1996.

Accounting Standards Board (ASB), ASB plans for accounting for smaller entities, Management Accounting: Magazine for Chartered Management Accountants, Volume 75, Number 9, p3, 1997.

Accounting Standards Board (ASB), Financial Reporting Standard For Smaller Entities, Management Accounting: Magazine for Chartered Management Accountants, Volume 75, Number 11, p6-8, 1997.

Accounting Standards Board (ASB), Amendment to Financial Reporting Standard For Smaller Entities Exposure Draft - July 1998, Accountancy International, p106-110, September 1998.

Accounting Standards Board (ASB), Financial Reporting Standard For Smaller Entities (FRSSE) (Effective June 2002), 2001.

Accounting Standards Board (ASB), Financial Reporting Standard For Smaller Entities (Effective June 2002) December 2001, Accountancy, Volume 129, Number 1302, p115-116, 2002.

Alexander D., Britton A., Financial Reporting, London: Chapman & Hall, 1993.

Allan A., Delport H.J., Henning J.J., Viljoen D.J., The Close Corporations Act 1984: A Basic Introduction, Port Elizabeth: Juta & Company Ltd, 1984.

Babcock J., OCBOA variations from GAAP must be noted, but not quantified, Outlook, Volume 66, Number1, p52, 1998.

Baskerville R., Simpkins K., Framework for differential reporting, Chartered Accountants Journal, p14-17, July 1997.

Basson D., Finansiële state is 'n halwe waarheid, Finansies & Tegniek, p8-10, 29 Junie 2001.

Blumberg R., Disclosure of information, Accountancy SA, p5-10, September 1996.

Burton E.J., Hillison W., Big GAAP/little gaap: Is accounting for small business in the balance?, American Journal of Small Business, Volume III, Number 3, p16-24, 1979.

Cairns D., Canada differential reporting, Accountancy, Volume 128, Number 1297, p100, 2001.

Campbell J., International update, Accountancy and Finance Update, p22-23, June 1996.

Chung S., Narasimhan R., Perceived value of mandatory audits of small companies, Managerial Auditing Journal, Volume 16, Number 3, p120-123, 2001.

The Canadian Institute of Chartered Accountants (CICA), Financial Reporting By Small Business Enterprises (SBE's) - Executive Summary, (http://www.cica.ca), 1999, Retrieved on 19 July 2002.

The Canadian Institute of Chartered Accountants (CICA), Notice of exposure draft, Accounting Standards Board proposed accounting recommendations, 2001.

The Canadian Institute of Chartered Accountants (CICA), Exposure draft, Differential reporting: Accounting Standards Board proposed accounting recommendations, (http://www.acsbcanada.org), July 2001, Retrieved 19 July 2002.

The Canadian Institute of Chartered Accountants (CICA), Practice advice, Practice advice for chartered accountants providing review and compilation services, (http://www.cica.ca), September 2001, Retrieved on 19 July 2002.

The Canadian Institute of Chartered Accountants (CICA). Exposure draft, Reporting on financial statements prepared using differential reporting options, (http://www.acsbcanada.org), February 2002, Retrieved on 19 July 2002.

The Canadian Institute of Chartered Accountants (CICA) Accounting Standards Board, Activities of the CICA Accounting Standards Board and Staff, FYI Accounting Standards, December 2001.

The Canadian Institute of Chartered Accountants (CICA) Accounting Standards Board, Activities of the CICA Accounting Standards Board and Staff, FYI Accounting Standards, March 2002.

Cilliers H.S., Benade M.L., Henning J.J., Du Plessis J.J., Close Corporations A Comprehensive Guide, Durban: Butterworths, 1993.

Cilliers H.S., Benade M.L., Henning J.J., Du Plessis J.J., Delport P.A., De Koker L., Pretorius J.T., Cilliers & Benade Corporate Law. Durban: Butterworths, 2000.

Cilliers H.S., Coetsee D., Stegman N., Van Schalkwyk C.J., Wenson N., Dempsey A., Cilliers and Mans corporate financial reporting in perspective, Third Edition, Durban: LexisNexis Butterworths, 2002.

Cleminson J., Rabin E., The reporting problems faced by small business entities in South Africa, Southern African Accounting Association, Port Elizabeth, SA, 2002.

Close Corporation Act no 69 of 1984.

Coetzee W., Legal backing for accounting standards in South Africa, Accountant: Official Journal Of The Institute Of Commercial And Financial Accountants Of Southern Africa, p10-11, April 2001.

Connolly J., Codification's OCBOA status debated, National Underwriter / Property & Casualty Risk & Benefits, Volume 102, Number 1, p26, 1998.

Coppin G., Reporting by smaller enterprises, Accountancy And Finance Update, p11-12, June 1996.

Davies M., Paterson R., Wilson A., UK GAAP Generally Accepted Accounting Practice in the United Kingdom, London: Longman, 1989.

Delport H.J., Pretorius J.T., Inleiding tot die Wet op Beslote Korporasies, Kaapstad: Juta en Kie Bpk, 1990.

Dugdale D., The statutory accounts of smaller companies: A burden or an aid to business?, Management Accounting, Volume 76, Number 2, p50-52, 1998.

Dugdale D., Hussey J., Jarvis R., The owner-manager and FRSSE: Can less mean more?, Certified Accountant, Volume 89, Number 11, p32-33, 1997.

Ekholm B., Troberg P., Que Vadis true and fair view?, Journal of International Accounting, Auditing & Taxation, Volume 7, Number 1, p113-129, 1998.

Ernst & Young: Aukland, Differential reporting, Accountancy - International Edition, p85, April 1997.

Evans C., IASB proposes standards for SME's, Accountancy magazine, (http://www.accountancymagazine.com), 2004, Retrieved on 20 October 2004.

Everingham G.K., Hopkins B.D., Generally accepted accounting practice: A South African viewpoint, Kenwyn: Juta & Co. Ltd, 1993.

Everingham G.K., Kana S.P., Corporate reporting, Landsdowne: Juta, 2000.

Everingham G.K., Kana S.P., Corporate reporting, Seventh Edition, Landsdowne: Juta, 2004.

Everingham G.K., Kleynhans J.E., Posthumus L.C., Introductory GAAP, Landsdowne: Juta & Co. Ltd, 2000.

Everingham G.K., Kleynhans J.E., Posthumus L.C., Introductory GAAP, Third Edition, Landsdowne: Juta & Co. Ltd, 2003.

Falk H., Gobdel B.C., Naus J.H., Disclosure for closely held corporations, The Journal of Accountancy, p85-89, October 1976.

Financial Accounting Standards Board (FASB), Private companies' financial reporting studied by FASB, Journal of Accountancy, p18, November 1983.

Fisher L., The true and fair override, Accountancy, p23, Desember 1994.

Fowle M., True and fair - Or only fairly true?, Accountancy, p29, June 1992.

Garbutt D., Big vs. small GAAP - The wrong problem, Accountancy SA, p29-31, April 1999.

Gouws D., More muscle in financial statements, Podium, p19-20, April 1995.

Govey I., Major changes to accounting rules, Charter, p58-59, September 1995.

Hattingh C., Differential accounting, Accountancy SA, p33-36, June 1999.

Hattingh C., Dan, the stationary man, Accountancy SA, p23-24, January 2001.

Hattingh C., The need for a second tier accounting system in South Africa, Accountancy SA, p35-37, May 2001.

Hepp G.W., McRae T.W., Accounting standards overload: Relief is needed, Journal of Accountancy, p52-62, May 1982.

Heymans H., Differential reporting standards, Accountancy SA, p31, July 2000.

Holgate P., Smith K., Big chance, little effort, lots of benefits, Accountancy, p93-94, April 1995.

Holmes S., Kent P., Downey G., The Australian differential reporting debate: A survey of practitioners, Accounting and Business Research, Volume 21, Number 82, p125-132, 1991.

The Institute of Chartered Accounting in England and Wales (ICAEW), Review of financial reporting by smaller entities: Memorandum of comment submitted to the ASB in May 2001 concerning the ED, "Review of the FRSSE" published in February 2001, Tech 7/01, May 2001.

The Institute of Chartered Accounting in England and Wales (ICAEW), Memorandum of comment submitted to the ASB in September 2001 concerning the ED, "Amendment to FRSSE 2001" published in June 2001, Tech 14/01, September 2001.

The Institute of Chartered Accountants of Scotland (ICAS), The Institute of Chartered Accounting in England and Wales (ICAEW), Company law review urged to adopt micro company category, (http://www.icas.org.uk), 1999, Retrieved on 14 June 2002.

The Institute of Chartered Accountants of Scotland (ICAS), The Institute of Chartered Accounting in England and Wales (ICAEW), ICAS publishes results of survey on use of FRSSE, (http://www.icas.org.uk), 2000, Retrieved on 14 June 2000.

The Institute of Chartered Accountants of Scotland (ICAS), The Institute of Chartered Accounting in England and Wales (ICAEW) Small Companies Working Party, Getting into shape, 1999.

The Institute of Chartered Accountants of Scotland (ICAS's) Small Companies Working Party, Breaking the code...A better reporting framework for small companies, October 1998.

International Accounting Standards Board (IASB), Accounting by small and medium entities and in emerging economies, (http://www.iasc.org.uk), 2001, Retrieved on 17 July 2002.

International Accounting Standards Board (IASB), Agenda paper 4, Standards advisory council meeting, Washington DC, October 2001,

International Accounting Standards Board (IASB), Information for observers, Accounting by small and medium-sized entities and in emerging economies, 2002.

International Accounting Standards Board (IASB), Discussion Paper: Preliminary views on accounting standards for small and medium-sized entities, 24 September 2004.

Ivancevich D.M., Ivancevich S.H., Cocco A., Hermanson R.H., New accounting standards and the small business - The focus is different for a small business, The CPA Journal, p23-25, July 1997.

Jackson E., The ASB's failure to exploit the FRSSE's potential, Accountancy: International Edition, Volume 119, Number 1244, p75, April 1997.

John B., Healeas S., Financial reporting standard for smaller entities: A fundamental or cosmetic change?, The association of chartered certified accountants, Certified accountants educational trust: London, 2000.

Joubert D.S., Corporate reporting - A different perspective, Accountancy SA, p4-6, January 1993.

Kent P., Munro L., Differential reporting and the effect of loan evaluations: An experimental study, Accounting Forum, Volume 23, Number 4, p359-377, 1999.

King H., FRSSE stands out from the crowd, Accountancy - International Edition, Volume 120, Number 1252, p70, 1997.

Koppeschaar Z., Differential reporting a small step in the right direction, Accountancy SA, p2-3, June 2002.

Lavigne A., Standards with a differential, CA Magazine, p49-50, October 1999.

Lee G.A., Modern financial accounting, London: Nelson, 1973.

Lee T., The will-o'-the-wisp of 'true and fair', The Accountant, Volume 187, Number 96, p16-18, 1982.

Lippitt J.W., Oliver B.L., Big GAAP, little gaap: Financial reporting in the small business environment, Journal of Small Business Management, p52-57, July 1983.

Luke J., The implications of the changes in SA GAAP, Accountancy SA, p23, July 2000.

Malvern J., FRSSE has not helped SME's: Compliance costs and fees charged to clients have not decreased, say accountancy firms (http://www.accountancymag.co.uk), 26 February 2001, Retrieved on 17 July 2002.

Marriott P., An agenda for the future small company auditing and reporting, Certified Accountant,Volume 89, Number 4, p32-34, April 1997.

Martin P., All creatures great and small, CA Magazine, p47-48, August 2000.

McAleese G., FRSSE: The solution to accounting for small companies?, Accountancy Ireland Magazine,Volume 33, Number 1, p18, 2001.

McCahey J., Differentiation in corporate reporting, Australian Accountant, p57-60, July 1987.

Mersereau A., Differential reporting: A change in Canadian GAAP that will be of interest to most Canadian corporations, CA Magazine, p30-32, June-July 2002.

Morley J., Who wants a FRSSE?, Accountancy, Volume 128, Number 1297, p104, September 2001.

Murphy R., Accountancy in the information age, Accountancy Age, (http://www.accountancyage.com) , 26 June 1997, Retrieved 28 Oktober 2004.

Murphy R., Small, but imperfectly formed, Accountancy - International Edition, p64, January 1998.

Nair R.D., Rittenberg L.E., Professional notes: Privately held businesses: Is there a standards overload?, Journal of Accountancy, p82-96, February 1983.

Naude S.J., Brooks P.E.J., Henning J.J, Viljoen D.J., Van Breda W.W., De la Rey E.M., Oor Beslote Korporasies/On Close Corporations, Bloemfontein: UOFS, 1995.

Newitt D., The reporting entity in practice: Empirical evidence, Charter, p50-52, October 1990.

Nexia International, The international handbook of financial reporting, London: International Thomson Business Press, 1997.

Nexia International, Ashton Read, Calabro Partners, Carson McLellan, Forsythes, Lord&Brown, Nelson Wheeler, Norton-Smith Waldhauser, Ord Partners, The international handbook of financial reporting, London: International Thomson Business Press, 1997.

Nexia International, Spicer & Oppenheim, The international handbook of financial reporting, London: International Thomson Business Press, 1997.

Nobes C., Introduction to financial accounting, London and New York: Routledge, 1992.

Olsson R., The perfect annual report: Does it exist?, The Australian Accountant, p542-546, September 1981.

Pain B., Blakemore J., True and fair: An international perspective, Accountancy SA, p12-15, May 1997.

Parker R.H., Nobes C.W., An international view of true and fair accounting, London: Routlendge, 1994.

Paterson R., Widening the GAAP, Accountancy, p96, May 2001.

Pietersen M.E., Kwalitatiewe eienskappe van finansiële inligting en die gebruikers van finansiële state, RAUREK Bulletin, p52-54, September 1992.

Prinsloo A., Issues paper two, Draft 2, October 2000.

Qua-Enoo G.A., Do readers of financial reports feally understand them?, Port Elizabeth, SA, 2002.

Reid W., Myddelton D.R., The meaning of company accounts, Brookfield: Gower, 1992.

Saenger E., Finansiële verslagdoening: Die noodsaaklike teorie-navorsing-praktyk verband, SA Journal of Economic and Management Sciences, Volume 14, Somer, p6-9, 1994.

Santoro J., International update: Latest developments in New Zealand, Accountancy and Finance Update, p23-24, August 1997.

Sharp I., Why the tizzy over the FRSSE?, Accountancy - International Edition, Volume 121, Number 1255, p74, March 1998.

Sleigh-Johnson N., In defence of the FRSSE, Accountancy, Volume 128, Number 1300, p92, December 2001.

Smith M., Qualitative characteristics in accounting disclosures: A desirability trade-off, Managerial Auditing Journal, Volume 11, Number 3, p11-16, 1996.

South African Institute of Chartered Accountants (SAICA), AC 100: Preface to statements of GAAP, 1983.

South African Institute of Chartered Accountants (SAICA), AC 101: Presentation of financial statements, 1998.

South African Institute of Chartered Accountants (SAICA), Techtalk, Accountancy SA, p1-4, March 2000.

South African Institute of Chartered Accountants (SAICA), Discussion paper 16: Limited purpose financial statements: A discussion draft, May 2000.

South African Institute of Chartered Accountants (SAICA), Small practices department update, October 2001.

South African Institute of Chartered Accountants (SAICA), Guide On Close Corporations, December 2001.

South African Institute of Chartered Accountants (SAICA), Draft exposure draft: Limited purpose financial statements, 2001.

South African Institute of Chartered Accountants (SAICA), Legal backing for and monitoring of compliance with accounting standards, Summary of theme discussions,(https://www.saica.co.za), 2002, Retrieved on 14 June 2000.

South African Institute of Chartered Accountants (SAICA), Attachment 6, The small enterprises financial reporting committee (SEFRC) meeting scheduled for 8 August 2002, 17 July 2002.

South African Institute of Chartered Accountants (SAICA), Attachment 7, The small enterprises financial reporting committee (SEFRC) meeting scheduled for 8 August 2002, 17 July 2002.

South African Institute of Chartered Accountants (SAICA), Financial reporting bill, 2002.

South African Institute of Chartered Accountants (SAICA), ED163: Framework for the preparation and presentation of limited purpose financial statements, June 2003.

South African Institute of Chartered Accountants (SAICA), Minutes of a meeting of the Limited Purpose Financial Reporting Committee, September 2004.

South African Institute of Chartered Accountants (SAICA), AC 000: Framework for the preparation and presentation of financial statements, February 2004.

Stegman N., Die behoefte aan 'n klemverskuiwing in die doelwitte van finansiële verslagdoening, RAUREK Bulletin, Number 3, p50-55, September 1994.

Swinson C., Accounts are about people, Accountancy, p85, April 2002.

Symington S.J., Close corporations in South Africa: An analysis and comments on the Close Corporations Act, 1984, as amended 1986, Cape Town: Arthur Young & Company, 1986.

The institute's technical standards staff, Getting technical: Financial statement preparation post-simplification, Charter, p56-57, May 1996.

United Nations Conference on Trade and Development, Report of the intergovernmental working group of experts on international standards of accounting and reporting on its eighteenth session, 15 November 2001.

United Nations Trade and Development Board, Accounting by small and medium-sized enterprises report by the UNCTAD secretariat, United Nations Conference on Trade and Development, 20 April 2000.

United Nations Trade and Development Board, Report of the intergovernmental working group of experts on international standards of accounting and reporting on its seventeenth session, United Nations Conference on Trade and Development, 31 August 2000.

United Nations Trade and Development Board, Accounting by small and medium-sized enterprises: Report by the ad hoc consultative group of experts on accounting by small and medium-sized enterprises, United Nations Conference on Trade and Development, 13 July 2001.

Uys D., Al wat u moet weet van eie beslote korporasie, Kaapstad: Lex Patria 1987. .

Van Dorsten J.L., South African business entities: A practical guide, Sandton: Obiter Publishers CC, 1991.

Vorster Q., Koen M., Koornhof C., Overholster J., Koppeschaar Z., Descriptive accounting, Durban: Butterworths, 2003.

Walton P., Differential reporting and the European community - A suitable case for treatment?, European Business Journal, Volume 7, p43-49, 1992.

Walton P., Differential reporting, Accountancy and Finance Update, p2-3, June 1998.

Werner C.A., Arnstein P., Culp D.M., Nelson D.A., Silverman E.J., Wyatt A.R., Official releases: Report of the committee on generally accepted accounting principles for smaller and/or closely held businesses, The Journal of Accountancy, p116-120, October 1976.

Wild K., Carter C., Filling The GAAP For Small Companies, Accountancy, Number 115, p1217, January 1995.

Williams S.M., Tower G., Differential reporting in Singapore and Australia: A small business managers' perspective, The International Journal of Accounting, Volume 33, Number 2, p263-268, 1998.

Wilson A., A GAAP in understanding, Accountancy, p93, February 1995.

APPENDIX A

QUESTIONNAIRES

<u>QUESTIONNAIRE:</u> Members of close corporations

1. How many members does the close corporations have? ☐

2. How many of the members are involved in the day-to-day management of the business? ☐

3. As an indicator of the size of the close corporation, please give estimates of the following attributes:

Turnover per year	R
Total assets	R
Number of employees	

4. How useful do you find the current form of financial statements?

Not useful	1	2	3	4	5	6	7	8	9	10	Very useful

5. Rate the following uses of your financial statements in order of importance.

   1 = least important use of financial statements

   10 = most important use of financial statements

   Tool of calculating taxation

1	2	3	4	5	6	7	8	9	10

   Raising loan finance

1	2	3	4	5	6	7	8	9	10

   Source of management information

1	2	3	4	5	6	7	8	9	10

   Financial information for decision-making purposes

1	2	3	4	5	6	7	8	9	10

Other (Please specify)..

....

1	2	3	4	5	6	7	8	9	10

6. How dependent are you on the financial statements for managerial information?

Not dependent	1	2	3	4	5	6	7	8	9	10	Very dependent

7. Does your financial statements provide you with useful information for:

7.1 planning,

Yes ☐ No ☐

If yes, please specify the information you find useful

....

....

....

....

7.2 decision-making,

Yes ☐ No ☐

If yes, please specify the information you find useful

....

....

....

....

7.3 control

Yes ☐ No ☐

If yes, please specify the information you find useful

....

....

....

....

If no in 7.1, 7.2 or 7.3, please specify the information you do not find useful

....

....

....

....

8. Rate the following sources of managerial information in order of importance

1 = least important for managerial information

10 = most important for managerial information

Income statement and notes prepared according to GAAP

1	2	3	4	5	6	7	8	9	10

Balance sheet and notes prepared according to GAAP

1	2	3	4	5	6	7	8	9	10

Cash flow statement and notes prepared according to GAAP

1	2	3	4	5	6	7	8	9	10

Income statement prepared according to tax rules

1	2	3	4	5	6	7	8	9	10

Cash flow forecasts

1	2	3	4	5	6	7	8	9	10

Other (Please specify)…………………………………………………………..

……………………………………………………………………………………….

1	2	3	4	5	6	7	8	9	10

9. Name the users of your financial statements to whom you send a copy to.

……………………………………………………………………………………………

……………………………………………………………………………………………

……………………………………………………………………………………………

……………………………………………………………………………………………

……………………………………………………………………………………………

……………………………………………………………………………………………

……………………………………………………………………………………………

10. Does the costs of your financial statements, according to you, exceed the benefits you receive from the financial statements?

Yes ☐ No ☐

11. When an acquisition/sale of an ownership interest in the close corporation occurs, what is the most important source of information?

financial statements ☐ other information ☐ both ☐

if other or both, please specify the other information

……………………………………………………………………………………………

……………………………………………………………………………………………

……………………………………………………………………………………………

……………………………………………………………………………………………

……………………………………………………………………………………………

……………………………………………………………………………………………

……………………………………………………………………………………………

……………………………………………………………………………………………

……………………………………………………………………………………………

12. What do you see as the objective of the financial statements of the close corporation?

…………………………………………………………………………………………………

…………………………………………………………………………………………………

…………………………………………………………………………………………………

…………………………………………………………………………………………………

…………………………………………………………………………………………………

…………………………………………………………………………………………………

13. Currently, close corporations normally comply with the Statements of Generally Accepted Accounting Practice (GAAP), that are applicable to listed companies. Should close corporations have a separate set of accounting standards which is limited for their own purpose.

Yes ☐ No ☐

If yes, please rate the following preparation methods for the financial statements of close corporations in order of preference

1 = least preferred for preparation

10 = most preferred for preparation

Tax basis

1	2	3	4	5	6	7	8	9	10

Cash basis

1	2	3	4	5	6	7	8	9	10

Accruals basis

1	2	3	4	5	6	7	8	9	10

Full GAAP

1	2	3	4	5	6	7	8	9	10

Managerial basis

1	2	3	4	5	6	7	8	9	10

Other (Please specify) ....
....

1	2	3	4	5	6	7	8	9	10

QUESTIONNAIRE: Bankers

1. How useful do you find the current financial statements of close corporations for credit analyses purposes?

Not useful	1	2	3	4	5	6	7	8	9	10	Very useful

2. How dependent are you on the financial statements of close corporations for credibility information?

Not dependent	1	2	3	4	5	6	7	8	9	10	Very dependent

3. Does the financial statements of close corporations provide you with useful information for credit analysis purposes?

Yes ☐ No ☐

If yes, please specify the information you find useful
....
....
....
....
....
....
....
....
....
....

If no, please specify the information you do not find useful

....

....

....

....

....

....

....

....

....

....

4. Do you request additional information to supplement the financial statements?

Yes ☐ No ☐

If yes, pleases specify the additional information requested

....

....

....

....

....

....

....

....

....

....

5. Rate the following sources of credibility information in order of importance

   1 = least important for credibility information

   10 = most important for credibility information

   Income statement and notes prepared according to GAAP

1	2	3	4	5	6	7	8	9	10

   Balance sheet and notes prepared according to GAAP

1	2	3	4	5	6	7	8	9	10

   Cash flow statement and notes prepared according to GAAP

1	2	3	4	5	6	7	8	9	10

   Members credibility

1	2	3	4	5	6	7	8	9	10

   Cash flow forecasts

1	2	3	4	5	6	7	8	9	10

   Budgets

1	2	3	4	5	6	7	8	9	10

   Management data

1	2	3	4	5	6	7	8	9	10

   Other (Please specify)…………………………………………………………...

   ………………………………………………………………………………………..

1	2	3	4	5	6	7	8	9	10

6. Will the non-compliance of the financial statements of close corporations with the statements of GAAP influence the decision for providing loan facilities?

   Yes ☐ No ☐

   If yes, please specify

   ....

   ....

   ....

   ....

   ....

7. Rate the following preparation methods for financial statements of close corporations in order of preference

   1 = least preferred for preparation

   10 = most preferred for preparation

Tax basis

1	2	3	4	5	6	7	8	9	10

Cash basis

1	2	3	4	5	6	7	8	9	10

Accruals basis

1	2	3	4	5	6	7	8	9	10

Full GAAP

1	2	3	4	5	6	7	8	9	10

Managerial basis

1	2	3	4	5	6	7	8	9	10

Other (Please specify) ....………………………

……………………………………………………………………………………………

1	2	3	4	5	6	7	8	9	10

8. Will the presentation of non-GAAP financial statements influence the interest rates or other bank charges when providing a loan or overdraft facilities to close corporations?

Yes ☐ No ☐

If yes, please specify

....

....

....

....

....

QUESTIONNAIRE: SARS

1. How useful do you find the current financial statements of close corporations for tax assessment purposes?

Not useful	1	2	3	4	5	6	7	8	9	10	Very useful

2. How dependent are you on the financial statements of close corporations for tax assessment purposes?

Not dependent	1	2	3	4	5	6	7	8	9	10	Very dependent

3. Does the financial statements of close corporations provide you with useful information for tax assessment purposes?

Yes ☐ No ☐

If yes, please specify the information you find useful

....

....

....

....

....

....

....

....

....

....

....

If no, please specify the information you do not find useful

....

....

....

....

....

....

....

4. Do you request additional information to supplement the financial statements?

Yes ☐ No ☐

If yes, pleases specify the additional information requested

....

....

....

....

....

5. Will the non-compliance of the financial statements of close corporations with the statements of GAAP influence the tax assessing process?

Yes ☐ No ☐

If yes, please specify

....

....

....

....

....

6. Rate the following preparation methods for financial statements of close corporations in order of preference

   1 = least preferred for preparation

   10 = most preferred for preparation

Tax basis

1	2	3	4	5	6	7	8	9	10

Cash basis

1	2	3	4	5	6	7	8	9	10

Accruals basis

1	2	3	4	5	6	7	8	9	10

Full GAAP

1	2	3	4	5	6	7	8	9	10

Managerial basis

1	2	3	4	5	6	7	8	9	10

Other (Please specify) ....……………………...

………………………………………………………………………………………………….

1	2	3	4	5	6	7	8	9	10

QUESTIONNAIRE: CFA's

1. What basis do you currently use in the preparation of financial statements for close corporations?

Full statements of GAAP ☐
(all measurement, recognition and disclosure requirements)
Partly statements of GAAP ☐
(all measurement and recognition, but less disclosure requirements)
Selected statements of GAAP ☐
(selected measurement, recognition and disclosure requirements)
Tax basis ☐
(full compliance with tax rules)
Cash basis ☐
(when cash is received or paid)
Other (Please specify)…………………………………………………………… ☐
…………………………………………………………………………………………
…………………………………………………………………………………………

2. Do you agree that compliance with statements of GAAP is a price to be paid for limited liability by close corporations?

Yes ☐ No ☐

3. Name the users of the financial statements of close corporations to whom you send copies to.

……………………………………………………………………………………………………..

……………………………………………………………………………………………………..

……………………………………………………………………………………………………..

……………………………………………………………………………………………………..

……………………………………………………………………………………………………..

……………………………………………………………………………………………………..

……………………………………………………………………………………………………..

……………………………………………………………………………………………………..

……………………………………………………………………………………………………..

4. Rate the following uses of the financial statements of close corporations in order of importance.

1 = least important use of financial statements

10 = most important use of financial statements

Tool of calculating taxation

1	2	3	4	5	6	7	8	9	10

Raising loan finance

1	2	3	4	5	6	7	8	9	10

Source of management information

1	2	3	4	5	6	7	8	9	10

Financial information for decision-making purposes

1	2	3	4	5	6	7	8	9	10

Other (Please specify)………………………………………………………… …….

………………………………………………………………………………………..

1	2	3	4	5	6	7	8	9	10

5. When an acquisition/ sale of an ownership interest in the close corporation occurs, what is the most important source of information?

financial statements ☐ other information ☐ both ☐

if other or both, please specify the other information

………………………………………………………………………………………………

………………………………………………………………………………………………

………………………………………………………………………………………………

………………………………………………………………………………………………

………………………………………………………………………………………………

………………………………………………………………………………………………

………………………………………………………………………………………………

………………………………………………………………………………………………

6. Does the cost of complying with statements of GAAP, according to you, exceed the benefits close corporations receive from the information in their financial statements?

yes ☐ no ☐

7. Should close corporations have their own separate set of accounting standards to comply with?

yes ☐ no ☐

If yes,

7.1 What would be the most useful basis?

1 = least useful basis

10 = most useful basis

Tax basis

1	2	3	4	5	6	7	8	9	10

Cash basis

1	2	3	4	5	6	7	8	9	10

Accruals basis

1	2	3	4	5	6	7	8	9	10

Full GAAP

1	2	3	4	5	6	7	8	9	10

Managerial basis

1	2	3	4	5	6	7	8	9	10

Other (Please specify) ……………………………………………………………………………

………………………………………………………………………………………………………

1	2	3	4	5	6	7	8	9	10

7.2 Should this separate set of accounting standards be:

A seperate accounting standard for smaller entities ☐

Differential reporting listed in each statement ☐

8. Are there some critical accounting standards to which close corporations should confirm?

yes ☐ no ☐

If yes, please rate the following accounting standard

1 = least critical

10 = most critical

AC 000 Framework for the preparation and presentation of financial statements

1	2	3	4	5	6	7	8	9	10

AC 100 Preface to Statements of GAAP

1	2	3	4	5	6	7	8	9	10

AC 101 Presentation of financial statements

1	2	3	4	5	6	7	8	9	10

AC 102 Income Tax

1	2	3	4	5	6	7	8	9	10

AC 103 Net profit or loss for the period, fundamental errors and changes in accounting policy

1	2	3	4	5	6	7	8	9	10

AC 104 Earnings per share

1	2	3	4	5	6	7	8	9	10

AC 105 Leases

1	2	3	4	5	6	7	8	9	10

AC 107 Events after the balance sheet date

1	2	3	4	5	6	7	8	9	10

AC 108 Inventories

1	2	3	4	5	6	7	8	9	10

AC 109 Construction contracts

1	2	3	4	5	6	7	8	9	10

AC 110 Accounting for investments in associates

1	2	3	4	5	6	7	8	9	10

AC 111 Revenue

1	2	3	4	5	6	7	8	9	10

AC 112 The accounting of changes in foreign exchange

1	2	3	4	5	6	7	8	9	10

AC 114 Borrowing costs

1	2	3	4	5	6	7	8	9	10

AC 115 Segmental reporting

1	2	3	4	5	6	7	8	9	10

AC 116 Employee benefits

1	2	3	4	5	6	7	8	9	10

AC 117 Discontinuing Operations

1	2	3	4	5	6	7	8	9	10

AC 118 Cash flow statements

1	2	3	4	5	6	7	8	9	10

AC 119 Financial reporting of interests in joint ventures

1	2	3	4	5	6	7	8	9	10

AC 123 Property, plant and equipment

1	2	3	4	5	6	7	8	9	10

AC 124 Financial reporting in hyperinflationary economies

1	2	3	4	5	6	7	8	9	10

AC 125 Financial instruments: Disclosure and presentation

1	2	3	4	5	6	7	8	9	10

AC 126 Related party disclosure

1	2	3	4	5	6	7	8	9	10

AC 127 Interim financial reporting

1	2	3	4	5	6	7	8	9	10

AC 128 Impairment of assets

1	2	3	4	5	6	7	8	9	10

AC 129 Intangible assets

1	2	3	4	5	6	7	8	9	10

AC 130 Provisions, contingent liabilities, and contingent assets

1	2	3	4	5	6	7	8	9	10

AC 131 Business combinations

1	2	3	4	5	6	7	8	9	10

AC 132 Consolidated financial statements

1	2	3	4	5	6	7	8	9	10

AC 133 Financial instruments: Recognition and measurement

1	2	3	4	5	6	7	8	9	10

AC 134 Accounting for government grants and disclosure of Government Assistance

1	2	3	4	5	6	7	8	9	10

AC 135 Investment properties

1	2	3	4	5	6	7	8	9	10

AC 137 Agriculture

1	2	3	4	5	6	7	8	9	10

9. Can close corporations have a different level of fair presentation than public companies?

yes ☐ no ☐

10. What do you see as the objective of the financial statements of the close corporation?

....

....

....

....

....

....

....

....