Financial Reporting by Small Companies in the UK: The Demand for Abbreviated Accounts

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Abstract

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

The aim of the study is to provide generalisable evidence of the utility of the statutory financial statements of small companies to the directors. It took the form of a postal questionnaire survey of the directors of a tranche of 385 companies meeting the 1999 EC size criteria for a small company. These are the companies that are most likely to be affected by proposals to lift the UK size thresholds that qualify companies to apply little GAAP. This paper focuses on the factors that influence the filing choices of the directors of these small companies and the demand for abbreviated accounts.

The results show that the majority of directors chose to file full accounts in the year preceding the survey. Whether full or abbreviated accounts were filed, the accountant's advice plays a key role. A range of reasons for the filing choice made are revealed and a logistic regression model provides evidence that the abbreviated accounts are likely to be the choice of directors of smaller companies, as measured by turnover, who consider there are cost benefits to the business from this choice. The average turnover of such companies is £0.9m. These results should be of interest to policy makers involved in reforming little GAAP in the UK, as well as those concerned with international harmonisation of financial reporting by small companies.

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1. Introduction

This study is set within the context of the current deregulatory trend in financial reporting by small companies in the UK and was supported by the ICAEW. For historical reasons, UK GAAP (generally accepted accounting principles) has evolved with the needs of large, public companies in mind, but since the 1980s the importance of the role played by small businesses in the country's economy has increased. Indeed, 99% of the business stock and 96% of companies have fewer than 50 employees and are therefore classified by the government for statistical purposes as small (SBS, 2000, Table 22).

This change of emphasis led to an escalation of the big GAAP/little GAAP debate. This debate is concerned with the question of whether it is necessary for small companies to be subject to the same extensive range of reporting requirements that govern large (often multinational) public companies and whether small companies should be exempt from some aspects of GAAP on the grounds of size and relative lack of public interest in their financial statements. One of the main difficulties is determining the criteria that should be used to exempt companies (Hussey, 1999), which seems surprising, since the accounting profession has spent almost a decade in developing a conceptual framework for financial reporting.

The result of the debate has been the gradual emergence of little GAAP, which consists of certain concessions and exemptions for smaller entities. The principal aim of the government in reforming the legal elements of the regulatory framework to develop little GAAP is to relieve the burden of compliance, which it is argued falls disproportionately on small businesses compared to their larger counterparts (DTI, 1985). Thus, the changes are aimed at reducing costs, rather than theoretical assumptions. Moreover, little attention has been given to any benefits and reforms are being made without generalisable empirical evidence how little GAAP is being received by the directors of small companies, who are the main users of the accounts (Carsberg, Page, Sindall and Waring, 1985). This is a serious omission and at odds the government's views on evidence based policy making (Cabinet Office, 1999).

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

The next section of this paper provides the background to the study by examining the development of little GAAP as it applies to small companies in the UK.[1] This is followed

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

by a description of the methodology. The results are presented and discussed in the fourth section and the paper ends by drawing conclusions.

2. The development of little GAAP in the UK

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

2.1 Exemptions from statutory disclosure

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

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

Table 1 Size thresholds for small companies

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

In 1997 the DTI amended the Companies Act 1985 (SI 1997/220) by introducing a revised Schedule 8 and a new Schedule 8A, which set out in full the provisions of Schedule 4 that apply to small companies. Under the provisions, a small company may choose to file full or abbreviated accounts with the Registrar of Companies, but must provide full financial statements for shareholders. A small company choosing to file abbreviated financial statements is not required to file a profit and loss account or a directors' report and may file an abbreviated or a shorter-form[2] balance sheet and notes thereto.

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

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

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

2.2 Audit exemption

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

In 1999 the DTI announced proposals to raise the thresholds again, possibly up to the maximum levels set by the EC (DTI, 1999b). In most EU countries the threshold is substantially higher than in the UK (typically, £2m-£4m), but there are also legal and regulatory differences, as well as variations in the company populations and size distributions. These factors make inter-country comparisons problematic. The rationale for this increase focuses mainly on potential cost savings for increased numbers of small companies. It is difficult to estimate how many companies would be affected by such a change. There are some 380,000 companies that file abbreviated accounts and since such accounts do not include turnover figures it is not possible to calculate how many of them fall within the current or proposed exemption levels (DTI, 1999c). Based on the accounts of 750,000 companies at Companies House where the turnover data is available, the DTI estimates that 520,000 (69%) are currently within the exemption threshold, and that lifting the level to £4.2m would increase the number by 185,000 to 705,000 (94%). In addition, an estimated 90,000 companies that currently file abbreviated accounts would be able to opt out if the threshold was raised to the maximum. This would bring the total number of companies to approximately 795,000 (DTI, 1999c, pp. 5-6).

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

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

2.3 Accounting standards

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

The result of the consultation showed clear support for some relief based on size, or a combination of size and public interest, and the working party recommended the promulgation of a specific financial reporting standard for smaller entities (CCAB, 1995). Accordingly, the ASB published an exposure draft (ASB, 1996) and subsequently issued the Financial Reporting Standard for Smaller Entities (FRSSE) (ASB, 1997 and subsequent revisions). The FRSSE is applicable to all reporting entities that qualify as small under the Companies Act 1985 and collects together in one document, and in simplified form, the accounting standards and other requirements for preparing and presenting the financial statements of smaller businesses.

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

2.4 Review of company law

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

2.5 Development of the theoretical framework

Little is known about the take-up levels of the filing options available to small companies or the reasons for their choices. The main benefit of filing abbreviated accounts, particularly for a small company with a single product, is that it makes much less information available to competitors (Davies, Paterson and Wilson, 1997). However, abbreviated accounts are an additional set of financial statements that are drawn from the full financial statements specifically for the purpose of delivery to the Registrar of Companies. Therefore, there are likely to be additional costs involved in taking up the option to file abbreviated accounts.

Government statistics do not allow the total number of small and medium-sized companies that are eligible to file abbreviated accounts to be calculated. However, in 1994 the CCAB estimated that only 35% of small and medium-sized companies eligible to file abbreviated accounts were doing so at that time. Actual figures for 1999/00 show that of the 835,900 large, medium and small companies[3] filing annual accounts at Companies House, 41% were small and medium-sized companies filing abbreviated accounts (DTI, 2000, Table F2, p. 44). Thus, it would appear that a significant proportion of qualifying companies make full public disclosure by choice, lack of knowledge of the alternatives or because it they are required to do so under company law.

There are three significant gaps in the literature regarding the financial reporting concessions offered by little GAAP in the UK:

- There is no empirical evidence on the appropriateness or sufficiency of the government's chosen size criteria of turnover, balance sheet total and number of employees for determining eligibility to apply little GAAP.
- There is a lack of evidence concerning the benefits and costs of applying little GAAP.
- It is not known why small companies differ in their choice of whether to apply little GAAP. For example, it is not known whether the directors of eligible companies who do not apply little GAAP make an informed decision or simply do not realise that they have a choice.

This paper begins to address these deficiencies by investigating the following research question:

What factors influence filing options taken by the directors of small companies?

This question is broken down into the following subsidiary questions:

1. What are the take-up levels of the fling options available under little GAAP as it was in 1999?
2. What are the reasons for the filing choices made?

[3] This excludes dormant companies and those filing group accounts or interim/initial accounts.

3. Do the size criteria in company law capture the disclosure needs of small companies?

3. Methodology

The study took the form of a large postal questionnaire survey following an exploratory study.[4] The sample companies were selected from FAME, which contains information on 270,000 British companies taken from the returns made to the Registrar of Companies. One limitation of this choice is that the database does not include many companies with a turnover of under £0.5m.[5] However, the information is detailed, up to date and easy to access. A search of the database was conducted at the beginning of March 1999 to identify all active, independent,[6] private limited companies that met the following size criteria[7] in the most recent year for which accounts were filed:

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

These search criteria provided a list of 11,648 companies filing full, audited accounts (£350,000 turnover being the audit exemption level at the time of selection). The list was sorted alphabetically and a systematic random sample taken by selecting every fifth company. This gave an initial list of 2,327 companies, from which 39 were later eliminated as they were outside the scope of the study, which reduced the list to 2,288. After two follow-ups, a total of 385 usable replies were received, giving a response rate of 17% and sufficient to allow the results to be generalised from the sample to the population.[8]

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

[4] The results of the exploratory study were subsequently published (Collis, Dugdale and Jarvis, 2001).
[5] Therefore the sample is not representative of companies below this level.
[6] Subsidiary companies were excluded.
[7] These are the maximum levels under EU law at the time the companies were selected.
[8] According to Krejcie and Morgan (1970, p. 608), for populations of 1m or more, the minimum acceptable sample size is 384.

4. Results and discussion

4.1 The sample companies

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

Table 2 Companies by size

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

N = 385
Source: FAME

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

4.2 Filing choice

At the time of selection, the most recent accounts filed by all the sample companies were full accounts. However, as described in section 2, the filing options set out in the Companies Act 1985 allow qualifying small and medium-sized companies to prepare and file either full audited accounts or unaudited abbreviated financial statements. As the qualification criteria are complex, it is not possible to be certain about the eligibility of the sample companies to apply this aspect of little GAAP, but on the basis of size, it is likely that all the sample companies would qualify.

Rather than ask the respondents about their practices in general, critical incident technique (Flanagan, 1954) was used to focus their attention on the filing decision taken the previous year. Whether the accounts filed are full or abbreviated, a director must sign the balance sheet on behalf of the board. Therefore, it is reasonable to assume that the principal directors of the sample companies would know what type of accounts the company had prepared. Table 3 shows their responses.

Table 3 Filing choice last year

Filing choice	No. of companies	% of companies
Full accounts	252	66
Abbreviated accounts	113	29
Uncertain/no response	20	5
Total	**385**	**100**

Although the sample consisted entirely of companies that had filed full accounts in the most recent year, Table 3 reveals that more than a quarter (29%) had filed abbreviated accounts the previous year. This must be interpreted in the context that the sample included companies that under the current size thresholds would not qualify as small and, therefore, would not have this option. Nevertheless, this analysis indicates that 29% had switched to filing full accounts. Unfortunately, it is not possible to ascertain whether this switch was due to a proximity to the threshold (or other change in eligibility), or some other factor. Some respondents volunteered that they were planning to file abbreviated accounts for the next accounting period.

It was noted in section 2 that the total number of small and medium-sized companies that are eligible to file abbreviated accounts is not known. Of the 835,900 large, medium and small companies[9] filing annual accounts at Companies House in 1999/00, 41% were small and medium-sized companies filing abbreviated accounts (DTI, 2000, Table F2, p. 44). This contrasts with the finding in the above table that 29% of companies had filed abbreviated accounts the previous year. There are three likely explanations for this difference, both of which are concerned with sample bias. First, the sample in the present study is biased towards companies filing full accounts and second, it is not representative of companies with a turnover under £0.5m, whose directors are more likely to take up this option. Third, the sample included companies that are not yet able to apply little GAAP. Further analysis found that the mean turnover of companies that chose to file abbreviated accounts was £0.9m and the mean turnover of those filing full accounts was £1.3m. However, this must also be interpreted in the context of the size of companies included in the sample.

4.3 Reasons for the filing choice

In order to explore the directors' perceptions of the costs and benefits of this particular aspect of little GAAP, respondents were asked to state the main reason for their filing choice. This was designed as an open question and the results have been derived from classifying the replies.

[9] This excludes dormant companies and those filing group accounts or interim/initial accounts.

Table 4 shows the reasons given by the 252 companies that had filed full accounts the previous year.

Table 4 Main reason for filing full accounts

Reason	**No. of companies**	**% of companies**
To meet our statutory obligations	63	25
On the advice of our accountant	56	22
We always file full accounts	30	12
We want to make full disclosure	25	10
There are cost benefits	15	6
Other	23	9
No reason given	40	16
Total	**252**	**100**

The most commonly cited reason is that the directors are meeting their statutory obligations (reported by a quarter of respondents) and for some of these companies filing full accounts is their only option, as they are not eligible to apply little GAAP. A further 12% said that they always filed full accounts. It is difficult to know whether these directors actively wanted to make full disclosure, were not eligible to file abbreviated accounts or were unaware that they have a choice.

Other respondents were more specific. Just under a quarter (22%) had filed full accounts on the advice of their accountant and it seems highly likely that the directors would take professional advice over this important decision. The survey found that 31% of the companies have a qualified accountant on the board of directors or on the staff and 84% have their accounts prepared by an external accountant. Therefore, accountancy advice should be readily available.

There may have been a number of reasons for advising full disclosure, the most important of which hinges on the question of the company's eligibility to file abbreviated accounts. Full disclosure would also be advised if the directors were planning a flotation or other form of external investment (Olsson, 1980). It might also be important if they wished to enhance their corporate image (Korn Ferry, 1986; Martin, 1989); indeed, one respondent mentioned that his company filed full accounts because in his opinion, "It looks more professional".

If there were no need to protect confidentiality, there may be commercial benefits from choosing full disclosure (a reason given by 10%). As one executive chairman explained, "We want to show the growth and performance of the company and that we've got nothing to hide". Although it is more expensive to prepare abbreviated accounts, as they are drawn from the full accounts, the cost benefits of filing full accounts were cited by fewer than 10% of respondents.

Table 5 shows the reasons given by the respondents of the 113 companies that had filed abbreviated accounts the previous year.

Table 5 Main reason for filing abbreviated accounts

Reason	**No. of companies**	**% of companies**
We want to disclosure legal minimum	42	37
On the advice of our accountant	22	20
There are cost benefits	18	16
To meet our statutory obligations	17	15
Other	2	2
No reason given	12	10
Total	**113**	**100**

It is widely acknowledged that, regardless of size, one of the aims of management is to comply with regulatory requirements with the minimum disclosure of information that would be advantageous to a competitor (Mace, 1977; Hussey and Everitt, 1991). This is reflected in the most common reason for filing abbreviated accounts (cited by 37%). As one respondent stated, "We've got something to hide!" A further 15% gave no details as to why they chose to file abbreviated accounts apart from the fact that it was the way they were meeting their statutory obligations.

Acting on their accountant's advice was the reason given by 20% of respondents, which is unexpected, as the application of the criteria for defining small and medium-sized companies can be complex. In addition to satisfying the basic size tests, companies must also satisfy other qualification criteria, which may be difficult to interpret.

More surprising is the finding that 16% of respondents consider that there are cost benefits attached to filing abbreviated accounts, despite the fact that the preparation of these accounts must be in addition to the full accounts prepared for shareholders.

4.4 Factors influencing the filing choice

Little is known about the factors that influence the filing choice and why the majority of companies do not take up the option to file unaudited abbreviated accounts. Although the government is planning to abolish this particular form of reduced disclosure, this is still an important issue as there are plans to offer a new form of simplified accounts. These will be applicable to an even greater range of smaller companies: all those qualifying as small under the 2002 EC maxima. From the analysis in the previous section it is clear that the accountant plays a key role in the filing decision, together with the directors' views on the costs and benefits of the options. In addition to these qualitative factors, company law implies that there are size factors that have a bearing on the financial reporting needs of smaller companies. Therefore, a logistic regression model was built to answer the following research question:

Do the size criteria in company law capture the financial reporting needs of small companies in terms of filing preferences?

This is broken down into a number of economic and theoretical hypotheses, which are presented below in the alternate form. The first arises from the economic rationale implicit in company law that the cost of financial reporting falls disproportionately on small companies:

H1: ceteris paribus, the likelihood of the directors choosing to file abbreviated accounts increases inversely with size of company. A subsidiary hypothesis relates to the issue of whether turnover, balance sheet total or number of employees more effectively measures size in this context.

The second and third hypotheses emanate from the contention that the filing choice is influenced by management's beliefs about the costs and benefits of filing abbreviated accounts:

H2: ceteris paribus, the likelihood of the directors choosing to file abbreviated accounts increases if their accountant recommends that they do so.
H3: ceteris paribus, the likelihood of the directors choosing to file abbreviated accounts increases with their belief that there are cost benefits in doing so.

Table 6 shows the variables in the analysis.

Table 6 Filing choice: Variables in the analysis

Variable	Description	Expected sign	Hypothesis tested
DV			
ABBREVD	Whether the company filed abbreviated accounts last year (1 = yes, 0 = no)		
IVs			
TOVER	Size of company as measured by turnover (£m)	-ve	H1
ASSETS	Size of company as measured by balance sheet total (£m)	-ve	H1
EMPLS	Size of company as measured by number of employees	-ve	H1
ADVISED	Whether the accountant advised the company on their filing choice (1 = yes, 0 = no)	+ve	H2
COSTBENE	Whether the director considers there are cost benefits in their filing choice (1 = yes, 0 = no)	+ve	H3

The data was screened for potential problems with collinearity among the independent size variables, which are measured on a ratio scale,[10] and Table 7 shows a satisfactory level of correlation with no suggestion of singularity.

Table 7 Filing choice: Correlation matrix of ratio IVs

Variable	TOVER	ASSETS	EMPLS
TOVER	1.000		
ASSETS	.620*	1.000	
EMPLS	.547*	.457*	1.000

Notes: N = 358
* Correlation is significant at the 0.01 level (2-tailed)

[10] ADVISED and COSTBENE are measured on a nominal scale and are not suitable for this treatment.

As the independent variables TOVER, ASSETS and EMPLS are not normally distributed in small companies, a non-parametric Mann-Whitney *U* test was conducted against the dependent variable (ABBREVD). This analysis tests each variable against the hypothesis that the two sub-samples in the dependent variable (those that chose to file abbreviated accounts and those that filed full accounts) come from populations with the same distribution. Table 8 gives details.

Table 8 Filing choice: Mann-Whitney U tests on non-parametric ratio IVs

Variable	ABBREVD	N	Mean rank	Sum of ranks	Mann-Whitney *U*	Wilcoxon W	Z	*p*
TOVER	0 No	252	198.27	49963.0	10391.0	16832.0	–4.128	.000
	1 Yes	113	148.96	16832.0				
	Total	365						
ASSETS	0 No	252	185.97	46865.5	13488.5	19929.5	–.804	.421
	1 Yes	113	176.37	19929.5				
	Total	365						
EMPLS	0 No	252	195.02	49144.0	11210.0	17651.0	–3.254	.001
	1 Yes	113	156.20	17651.0				
	Total	365						

The table shows a significant difference in the mean ranks of the two sub-samples in the case of TOVER and EMPLS, which allows the hypothesis for each to be rejected. However, no significant difference is present in relation to ASSETS, so the hypothesis is not rejected and this variable is not entered in the predictive model.

The remaining independent variables are dichotomous dummy variables measured on a nominal scale. Therefore, chi-square tests were conducted to test the same hypothesis that the two sub-samples are not independent of each other. Table 9 shows the results.

Table 9 Filing choice: Chi-square tests on nominal IVs

Variable		ABBREVD 0 No	ABBREVD 1 Yes	N	Chi-square	df	*p*
ADVISED	0 No	156	79	235	0.785	1	.376
	1 Yes	56	22	78			
	Total	212	101	313			
COSTBENE	0 No	197	83	280	8.376	1	.004
	1 Yes	15	18	33			
	Total	212	101	313			

The probability statistic in relation to ADVISED indicates that there is no significant difference between the two sub-samples. This means that directors choosing to file abbreviated accounts and those choosing to file full accounts are similar in terms of relying on the advice from their accountant. Therefore, the hypothesis is not rejected and H2 is rejected. However, there is a significant difference in the two sub-samples in terms of seeing their filing choice as bringing costs benefits and, therefore, evidence to reject the hypothesis in relation to COSTBENE.

The first logistic regression model was developed to test the hypothesis that the likelihood of the directors choosing to file abbreviated accounts increases inversely with the size of the company as measured by turnover and number of employees respectively (H1). The results are shown in panels A and B in Table 10. The final model tests the hypothesis that the likelihood of the directors choosing to file abbreviated accounts increases with their belief that there are cost benefits in doing so (H3). The results of this test are shown in panels C of Table 10.

Table 10 Filing choice: Logistic regression model

	Variable	B	SE	Wald	df	*p*	Exp(B)
Panel A	TOVER	-.367	.122	9.088	1	.003	.693
	Constant	-.411	.165	6.187	1	.013	.663
Panel B	EMPLS	-.019	.010	3.760	1	.052	.982
	Constant	-.545	.170	10.287	1	.001	.580
Panel C	TOVER	-.331	.134	6.119	1	.013	.718
	COSTBENE	.870	.381	5.119	1	.022	2.388
	Constant	-.498	.190	6.845	1	.009	.608

Notes: N = 385
Model summaries:
Panel A: Chi-square 10.186; df 1; p <0.01; -2 log likelihood 441.517; pseudo R^2 .039
Panel B: Chi-square 3.971; df 1; p <0.05; -2 log likelihood 447.732; pseudo R^2 .015
Panel C: Chi-square 14.539; df 2; p <0.01; -2 log likelihood 379.137; pseudo R^2 .063

Interpreting the table, the probability statistics in panels A and B show that TOVER is significant whereas EMPLS is not. The results in panel C demonstrate that when TOVER and COSTBENE are combined in the model, both are significant. The factor coefficient for TOVER indicates the expected negative relationship between the size of turnover and choosing to file abbreviated accounts. This provides evidence to accept H1 in terms of turnover. The positive sign on the factor coefficient for COSTBENE indicates that cost benefits are associated with the filing of abbreviated accounts, and this evidence allows H3 to be accepted.

It is notable that the model shown in panel A, where turnover is the sole explanatory factor, has a higher level of significance and a higher Wald value than the model shown in panel C where cost benefits are added. However, comparison of the pseudo R^2 results shows that the first model only explains 4% of the demand for full accounts, whereas the final model accounts for 6%. This suggests that further research is required to identify other factors, but for the time being it can be concluded that turnover alone is sufficient to capture the financial reporting needs of small companies in terms of filing preferences. This is an important finding and has implications for the planned regulatory reform of this aspect of little GAAP.

5 Conclusions

The way in which little GAAP has emerged in the UK suggests that policy makers have taken an arbitrary and piecemeal approach to reform. This is reflected in the number of changes to disclosure requirements and also the frequency with which the qualifying size thresholds are revised. This is surprising, given the publication of the conceptual framework (ASB, 1999), which provides a theoretical underpinning for financial reporting in the UK. The government's rationale for the emergent little GAAP rests on reducing the cost of financial reporting by small companies and little attention has been given to any benefits. Moreover, changes are being made without generalisable evidence of how little GAAP is being received by the main users of the statutory accounts, the directors of small companies themselves. This too is surprising, given the government's stance on evidence based policy making (Cabinet Office, 1999).

This study addresses some of the deficiencies in the literature and focuses on a tranche of companies that are most likely to be affected by proposals to lift the size thresholds that qualify companies to apply little GAAP. At the time of selection, all the sample companies had filed full accounts, but the survey reveals that the previous year 30% had filed abbreviated accounts. The average turnover of companies that chose to file abbreviated accounts was £0.9m whilst the average turnover of companies filing full accounts was £1.3m.[11]

Reduced disclosure is not seen universally as being beneficial to the business. Some of the directors who had filed full accounts stated that their main reason for their choice was because they specifically wanted to make full disclosure. Thus, the option to file abbreviated accounts is seen as advantageous in some companies, but not in others. This provides further evidence of the heterogeneity present in the small business sector (Curran and Blackburn, 2001).

Whether they chose to file full or abbreviated accounts, a significant proportion of directors made the decision based on advice received from their accountant. This is not surprising, as accountants are in the best position to offer guidance on this highly regulated matter. A key factor in the filing decision is the company's eligibility to file abbreviated accounts. In addition to satisfying the basic size tests, companies must also satisfy other qualification criteria, which may be difficult to interpret and therefore require professional advice. A second important factor is that the accountant knows the client's business and can therefore discuss the advantages and disadvantages of filing abbreviated accounts, which protect commercial confidentiality but also incur higher accountancy fees.

Two factors that explain the demand for abbreviated accounts are revealed. Empirical evidence is provided that the abbreviated accounts are filed by smaller companies, as measured by turnover, but not in terms of balance sheet total or number of employees. This is an important corrective to earlier work by Keasey and Short (1990) on this topic. In addition, abbreviated accounts are filed by the directors of companies who see cost benefits for the business in doing so. This may seem surprising, given the additional accountancy costs associated with preparing abbreviated accounts, but suggests that these are outweighed by the benefit of protecting commercial sensitive information.

These results have important implications for the reform of company law. First, proposals in the UK to raise the turnover threshold to £4.8m would not be seen as a benefit by many companies. Second, it is apparent that turnover alone is a sufficient measure for capturing the net benefits of full or reduced disclosure by small companies.

[11] Care must be taken when interpreting this finding, as the sample was not fully representative of companies with a turnover of less than £0.5m.

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