International Financial Reporting Standards and Differential Reporting

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Abstract

From 2005, Regulation 1606/2002/EC will require all entities listed on European stock exchanges to prepare consolidated accounts in accordance with International Financial Reporting Standards (IFRSs). However, little attention has been directed to the impact the regulation will have on unlisted entities, particularly small and medium-sized enterprises (SMEs), which represent the majority of businesses in the European Union.

This paper examines the international development of financial reporting standards for smaller entities from a UK perspective and commences with a review of the key arguments relating to differential reporting in the literature. Differential reporting is now established in a number of countries, but it appears to have been developed with little knowledge of the needs of the users of financial statements. Whilst this is generally recognised, very little research has been conducted to remedy this deficiency.

The main part of the paper examines the three elements of differential reporting that have been introduced in the UK for qualifying small entities: abbreviated accounts, the Financial Reporting Standard for Smaller Entities (FRSSE) and exemption from the statutory audit. The discussion is expanded by drawing on the results of a study by the authors of 385 UK companies that conformed to the 1999 EC definition of 'small'. Finally, drawing on principal issues of differential reporting and the case study, the paper discusses the issues that the IASB should be addressing if they are to introduce an IFRS for small businesses.

1. Introduction

This paper examines the international development of financial reporting standards for smaller entities from a UK perspective. Small entities are an important area of study, as one of the most significant changes in the world economy during the last 20 years has been the increasingly valued role played by small and medium sized enterprises (SMEs). Recent statistics show that in the UK small firms account for 43% of employment (SBS, 2002), in Europe they contribute 66% (European Communities, 2002) and in OECD countries, SMEs account for 60-70% of jobs (OECD, 2000). Most governments recognise the significant contribution of SMEs, irrespective of their political complexion and global position, and this is often reflected by government support for smaller entities.

In the UK, the disclosure of financial and other information through financial reporting is only a requirement for a specific group of SMEs: limited liability partnerships and limited companies. Limited liability partnerships are a new corporate business vehicle that have been permitted since April 2001 and are based on the traditional form partnership, but with limited liability for members. The total number of registrations in the first year was 1,940 (DTI, 2002). Limited liability companies can be registered either as private or public limited companies and both types offer limited liability to members. More than 99% are private companies that can only trade their shares privately, compared to 0.8% that are public companies and can raise funds on the capital markets (DTI, 2002). Analysing the statistics from an employment perspective, we find that of the total stock of 862,270 limited companies, 96% are small companies with fewer than 50 employees (SBS, 2002).

Research in the UK shows that the financial statements of SMEs provide important information for raising finance and for helping owners and managers with planning, control and decision making, as well as a number of other useful functions in promoting the financial well-being of the business (Berry, Citron and Jarvis, 1987; Carsberg, Page, Sindall and Waring, 1985; Collis and Jarvis, 2002). Although, many more financial statements are prepared for small private companies than for large listed companies, historically the rules and regulations have addressed issues associated with large public companies (Jarvis, 1996).

The regulatory framework for financial reporting in the UK is known as UK GAAP (Generally Accepted Accounting Principles). Differential reporting is the idea that different entities should be subject to different accounting rules (Harvey and Walton, 1996) and this has given rise to a controversial debate known as the big GAAP/little GAAP debate, the main focus of which is whether there should be different accounting rules for large and small entities. The debate was fuelled by the rapid expansion of financial regulations in the early 1990s in terms of volume and complexity, which lead to a concern that compliance imposes a disproportionate burden on small enterprises compared to their larger counterparts. More recently, the introduction of International Financial Reporting Standards (IFRSs) by International Accounting Standards Board (IASB) and its predecessor has extended the debate. IFRSs are explicitly designed to meet the needs of listed companies and no reference is made to the appropriateness of IFRSs to SMEs.

The objective of this paper is to explore the issues related to differential reporting in the context of the introduction of IFRSs by the IASB. The paper begins by reviewing the principal issues of differential reporting and uses the literature relating to UK accounting standards and research to support this review. This is followed by a case study, which examines differential reporting practices in the UK. The case study is supported by results from a recent study of practising accountants and previous research carried out with directors of small private companies (Collis and Jarvis, 2000). Finally, drawing on principal issues of differential reporting and the case study, the paper discusses the issues that the IASB should be addressing if they are to introduce an IFRS for small entities.

2. The principal issues of differential reporting

The issues to be discussed in this section closely relate to those frequently raised in the debate regarding the frame of reference for developing accounting standards and other accounting principles. The following details these issues and discusses their importance in the differential reporting debate.

2.1 Users

According to the conceptual framework in the UK, the Statement of Principles of Financial Reporting (ASB, 1999), the objective of financial statements is to provide useful information to a wide range of users in making economic decisions. In addition, they show the results of management's stewardship of the resources entrusted to the management of the enterprise. The Statement of Principles identifies seven user groups of the financial statements of reporting entities:

- present and potential investors
- lenders
- employees
- customers
- suppliers and other trade creditors
- government and their agencies
- the public

Several other reports in the UK and the US have identified a similar group of users (for example, The Corporate Report (ASSC) 1975; Solomons, 1989; McMonnies, 1988; AICPA, 1973). However, these reports do not explicitly discuss the size of company as an issue in terms of corporate reporting. The whole tenor of these reports is that corporate reporting is an issue that relates exclusively to large companies. For example, these documents include references to the stock market, consolidated accounting and goodwill which are all issues that are very unlikely to be of concern to small entities (Jarvis, 1996). This raises the question of whether the users of the financial statements of SMEs differ from those of large companies.

Research in the UK and Ireland, although very limited in volume, indicates that there is a difference between the main users of the financial statements of large companies and those of smaller entities. The main users of the accounts of small companies have been identified as management/the directors (Page, 1984; Carsberg *et al*, 1985; Barker and Noonan, 1996; Collis and Jarvis, 2000). In terms of finance, smaller entities are much more likely to use bank finance than equity (Cosh and Hughes, 1996). This is simply because most small entities do not have access to the capital markets. In the context of being a main provider of finance to SMEs, banks have been identified as a major user of SME financial statements (Berry *et al*, 1987). It is also acknowledged, in the Statement of Principles (ASB, 1999), that large companies have a much broader range of users than small companies.

The recognition that there are user differences raises a further question of whether the needs of users of the financial statements of smaller entities differ from those of the users of the financial statements of large companies. Unfortunately, there is very little evidence on this issue. However, the research that does exist suggests that there are differences. This may not necessarily involve differences in the nature of the information but more on the emphasis placed on certain specific items of information due to the relative complexity of the activities of the business, and the availability of up-to-date information demanded by lenders (Berry *et al*, 1987). For example, large companies are likely to produce detailed and timely management accounting information, which bank lenders may use to monitor the company's position and performance. It is unlikely this information would be available from small companies and the bank in this case may have to rely on the annual financial statements for monitoring loans.

2.2 Stewardship and agency relationships

Stewardship refers to the evaluation of the management by the owners of an enterprise in assessing their success in achieving organisational objectives (Arnold, Hope, Southworth and Kirkham, 1994). Stewardship, as earlier mentioned, has been identified as one of the main objectives of financial statements. The influence of stewardship is also strong in UK legislation governing accounting practice.

Whilst in the case of large companies ownership and management are separate in small companies there is often no separation. If there is no separation between ownership and management, the concept of stewardship is redundant and therefore cannot be one of the main objectives of financial statements for such companies.

This relationship between the owners, that is the shareholders, and managers has also been captured within the wider framework of agency theory (Jensen and Meckling, 1976). The agency model focuses on two individuals: the principal and the agent, where the principal delegates decision-making responsibilities to the agent. It is recognised that there is a need for the principal to monitor the behaviour of the agent and this is the role of financial statements. Banks are important suppliers of finance to small businesses and will use the financial statements to monitor the performance of owner/managers of small businesses (Berry, Ross, Citron and Jarvis, 1984). In the context of bank lending, an agency relationship exists between the small businesses and the banks where the bank is the principal and the owner-managers of the enterprise are their agents.

Therefore, although in traditional terms the concept of stewardship may be an inappropriate objective of financial statements, for small businesses in the wider framework of agency theory these statements are likely to play a crucial role in the relationship between banks and the managers of small businesses.

2.3 Complexity

The debate on differential reporting is often also referred to as the big GAAP/little GAAP debate. A common argument in the debate is that large companies have complex transactions and that they provide highly aggregated information, which requires specific rules to deal with them; for example, accounting for business combinations. However, such complexities are rarely relevant to small companies.

2.4 Costs and benefits

There are costs and benefits associated with financial reporting. The costs mainly relate to the preparation of the financial statements. Evidence suggests that the size of the enterprise has an impact on the cost of producing financial statements, so that costs are proportionally higher for small companies (Harvey and Walton, 1996). The benefits are associated with what the enterprises and users of financial statements receive from the use of the statements in monitoring and making decisions. In terms of the usefulness of the financial statements therefore, ideally regulations should only be imposed if the benefits exceed the costs.

Regulators, particularly governments, have focused on the costs associated with financial statements and have tended to ignore the benefits. An example of this is the statutory audit in the UK. In many countries, the audit has been seen primarily by a number of governments as an undue burden on small businesses due to the cost. Any benefits derived from the audit have been disregarded. This has resulted in legislation exempting small businesses from a statutory audit. However, research in the UK (Collis, Jarvis and Skerratt, 2001), indicates that there are a number of benefits and it is recognised that a large proportion of owner-managers of small companies would continue to have their financial statements audited even if there was no legal requirement to do so. These small companies clearly recognise that the benefits of the audit exceed the costs.

This unbalanced approached to regulation, if unchecked, could result in the introduction of new regulations having a negative impact on the small business community which governments are trying to support.

2.5 Decision usefulness

The argument relating to decision usefulness to the users of financial statements is that if this is one of the objectives of financial reporting, and it is recognised that statements of large businesses are used for a much wider set of decisions than those of small businesses (ASB, 1999), then more extensive disclosure requirements are likely to be required by large businesses. In contrast, small businesses may want their statements to be restricted in terms of disclosure to reflect the needs of owner-managers for planning, control and decision making and bankers for lending decisions.

2.6 Understandability

Closely aligned to the complexity issue is the principle of understandability. The Statement of Principles for Financial Reporting (ASB, 1999, Para.3.26) states that 'Information provided by financial statements needs to be understandable - in other words, users need to be able to perceive its significance…' Although the distinction between large and small companies is not referred to in the Statement of Principles, it is reasonable to assume that compared to the users of small company accounts, the users of financial statements of large listed companies have a much more sophisticated knowledge. Therefore, it might also be assumed that they have a greater understanding of international accounting standards because of the need to make economic decisions based on complex detailed accounting regulations (Martin, 2002).

2.7 Universality

Universality is a key argument against differential reporting. The universality argument focuses on the assumption that compliance with GAAP leads to a true and fair view. GAAP should be applied universally, as statutory accounts cannot give a true and fair view of the activities of the business if there are different accounting rules for different sized companies. Moreover, a distinction among companies according to size would involve an arbitrary cut off, which would be hard to defend (Carsberg *et al*, 1985). In the UK fears that differential reporting could impair the truth and fairness of the accounts were expressed by several of those who submitted written comments on the Consultative Committee of Accountancy Bodies' consultative document (CCAB, 1995). However, the CCAB working party took legal advice, which confirmed that there could be a different true and fair view for small and large companies.

It is questionable, however, whether a state of universality exists. There are already embedded in the regulations a number of exemptions and concessions relating to the type of industry as well as depending upon size. It is also the case that if a number of the fundamental principles governing accounting, such as measurement, are applied within differential reporting frameworks, the strength of the argument of universality is limited.

2.6 Definition of small and medium size enterprises

An important issue in the debate on differential accounting is the problem regarding the criteria for differentiation. This raises the question: What constitutes a SME? In the past regulators have adopted quantitative criteria; for example, the EU uses turnover, assets and number of employees.

Having quantitative size definitions arguably creates clarity for regulators, the enterprise and other interested parties. The mere physicality and countability of quantitative criteria is the attraction. These definitions are often aligned to turnover, the number of employees and the value of the assets. If the criteria are to be helpful to the enterprises themselves, it is important that the benefits of the particular regulation to users should exceed the costs of compliance and administration. However, where forms of differential reporting have been introduced, there is very little evidence that this issue has been addressed. A major limitation of applying a common quantitative definition internationally is that what is considered a small business in one country may not be considered small in another country because of the relative economic activities between the two countries.

The use of qualitative criteria for defining small companies is likely to take into account the needs of unprotected stakeholders of companies and where a business could be classified as in the public interest. An example of an unprotected stakeholder could be a small shareholder of a company who is not a director of the company. In the case of a particular stakeholder it may be appropriate through regulation to ensure such stakeholders will have access to a certain level of information about the company that say is afforded by full disclosure requirement accounting standards. An example of companies who could be categorised as having businesses in the public interest would be financial institutions, such as banks, which receive and bank deposits from the public.

There is also an argument for not specifying a definition of size of business and leaving the entity to decide which is the most appropriate basis to report within a given framework of accounting. This approach follows the argument that the entity will choose the reporting base, which takes account of the costs and benefits, understandability and complexity to satisfy the needs of management and external users.

3. The UK as a case study

The case study draws on research from accountants who are members the ACCA, one of the UK's professional accountancy bodies, and hold an auditing practice certificate. The email questionnaire focused on their clients' filing options, their views on the statutory audit, the use by their clients of Financial Reporting Standard for Smaller Entities (FRSSE) and abbreviated accounts. In addition, evidence is drawn from a postal questionnaire survey of the directors of 385 small companies on their use of the financial statements (Collis and Jarvis, 2000).

3.1 The development of little GAAP

Prior to the Companies Act 1981, companies in the UK were governed by identical financial reporting and disclosure requirements, regardless of size, industry or public interest. Thus, the Companies Act 1981 was the first step in the development of little GAAP in the UK. In recent years developments have focused on three initiatives: abbreviated accounts, the Financial Reporting Standard for Smaller Entities (FRSSE) and exemption from the statutory audit. In the case of abbreviated accounts and the FRSSE, the businesses that can adopt these reporting bases are those companies defined as small in the Companies Act 1985. In the case of the audit exemption a separate criteria is adopted. These three initiatives will be reviewed individually.

3.2 Abbreviated accounts

The Companies Act 1985 allowed small and medium size companies as defined in the Act to file abbreviated accounts with the Registrar of Companies, although companies are required to furnish shareholders with the full set of accounts. The Act thereby recognises shareholders as an important user. Abbreviated accounts, therefore, are an additional set of financial statements drawn from the full financial statements. The information content of abbreviated accounts is considerably less than the full set of financial statements. For example, companies are not required to file a profit and loss account or a directors' report.

It seems that the main motive behind this initiative was to enable small companies to avoid making information public that may be of commercial benefit to competitors (for example, the amount of profit or loss). The general usefulness of abbreviated accounts to users must be questionable. It is likely banks and other important creditors would be able to access the full set of accounts because their influential and powerful position vis-à-vis the company. Regulatory bodies, such as ABTA which regulates travel agents, could also insist on a full set of accounts from the company as a condition of registration.

However, by electing to file abbreviated accounts the directors will incur the additional accounting cost involved in producing these accounts. In the light of the government's determination to reduce costs for small firms it is therefore surprising that this option was introduced.

In view of the extensive range of exemptions allowed in abbreviated accounts, they clearly cannot be held to give a true and fair view. Since they are not intended to present a true and fair view, there is no requirement for them to comply with the disclosure provisions contained in accounting standards. However, as abbreviated accounts are based on full financial statements the measurement methods adopted will be consistent with those set out in the accounting standards.

Table 1 is taken from the survey of accountants and gives details of the percentage of each respondent's clients who file abbreviated accounts.

Table 1 Proportion of clients filing abbreviated accounts

Proportion of clients	**Number of respondents**	**Percentage of respondents**
0 - 10%	88	22
11 - 25%	24	6
26 - 50%	26	6
51 - 75%	14	3
76 - 90%	43	11
91 - 99%	91	22
100%	122	30
Total	**408**	**100**

Source: ACCA, 2003

The table shows that more than half (52%) stated that over 90% of their clients file abbreviated accounts (the average was 75%). This demonstrates that a significant proportion is taking this option. Indeed, this is supported by Companies House records, which show that 42% of all filed accounts were represented by small companies filing abbreviated accounts in 2000/1 (the first year that this figure was published separately for small companies).

The study of directors (Collis and Jarvis 2000) found that companies filing abbreviated accounts are more likely to have a turnover of under £1m and those filing full accounts to have a turnover of £1m or more. The main reason given by the directors of these companies for electing to file abbreviated accounts was that it was the legal minimum and to protect confidentiality. This supports the view that one of the main aims of management is to comply with regulatory requirements with minimum disclosure of information that would be of advantage to a competitor (Mace, 1977; Hussey and Everitt, 1991). The research however, did not reveal why smaller companies in the sample wish to preserve confidentiality at a cost of producing additional set of accounts.

It seems that the external accountant is very influential in the decision of the directors of the small company in electing to opt for the filing of abbreviated accountant. The study of accountants found that 81% claimed to be influential in the decision and 15% said they were partially influential. This response supports the evidence from the survey of directors (Collis and Jarvis, 2000).

The recent Company Law Review proposes that this option should not continue. This may be because of the additional cost of producing abbreviated accounts. Certainly this would be in line with the UK government's policy of reducing the cost burden on small business. It may also be that it is considered that the reduction in disclosure is more comprehensively accounted for in the FRSSE.

3.3 The FRSSE

The FRSSE was issued in November 1997 and there have been periodic revisions to take account of new standards since then. It is applicable to all reporting entities that qualify as small under the Companies Act. The objective of the FRSSE 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 entity that is useful to users in assessing the stewardship of management and for making economic decisions, recognising that the balance between users' needs in respect of stewardship and economic decisions-making for smaller entities is different from that for other reporting entities' (ASB, 2001, p. 9). Noticeably this statement recognises that there is an important distinction regarding stewardship between large and small companies, however, it does not specifically refer to the extent and nature of the difference between economic decision making and stewardship. This difference, arguably, can only be explored in relation to users and their needs particularly in the wider context of agency theory.

The main aim of the FRSSE is to reduce disclosure requirements of the full array of accounting standards. The FRSSE is 50 disclosure requirements lighter than the full set of standards. The emphasis appears therefore to be on reducing compliance costs. However, the focus of reduced disclosure will not necessarily result in significantly shorter accounts, since many of the disclosures were rarely or never applicable to smaller companies. 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.

In terms of reducing the cost and complexity it is questionable if much has been gained. Similarly in terms of enhancing understandability and decision-usefulness it is doubtful if significant movement in this direction has taken place. Some argue that the FRSSE has not gone far enough and if the ASB really wanted to help small companies '…it would have recognised that they are not just scaled-down versions of large ones. The accounts users, the purpose they use the accounts for and the relationships among stakeholders are typically quite unlike those in large companies, and there is much less public interest in their activities… The ASB's reluctance to adopt different recognition and measurement rules is what stops it from making a much more radical reduction in the reporting burden on small companies' (Murphy and Page, 1998, p. 87).

Table 2 shows the percentage of practising accountants' eligible clients who have their have their annual accounts prepared using the FRSSE.

Table 2 Proportion of clients using the FRSSE

Proportion of clients	**Number of respondents**	**Percentage of respondents**
0 - 10%	45	13
11 – 50%	11	3
51 – 90%	49	14
91 - 99%	40	11
100%	209	59
Total	**354**	**100**

Source: ACCA, 2003

It can be observed from the table that the FRSSE is used to prepare the accounts of 59% of clients. The average percentage of clients eligible to adopt the FRSSE was 83%. This high take up level is supported by evidence from a study by the Institute of Chartered Accountants in Scotland examined 100 sets of accounts and found that 49% had adopted the FRSSE (ICAS, 2002). **RWJ - you have 2001 in the references**

Table 3 shows the results from the directors' survey in relation to a question that asked whether the company would be preparing its statutory annual accounts in accordance with the FRSSE shortly after it was introduced (Collis and Jarvis, 2000).

Table 3 Directors' future decision regarding adoption of the newly introduced FRSSE

Decision	**Percentage of companies**
Will take professional advice	62
Undecided	12
No	11
Yes	10
No response	5
Total	**100**

Source: Collis and Jarvis, 2000, p. 42

Table 3 shows that whilst only 10% of directors of small companies said that they would adopt the FRSSE, 62% indicated that will seek advice from their accountants before deciding whether to prepare their accounts in accordance with FRSSE. This response is perhaps not surprising considering the technical nature of the choice. This is further supported by the survey of practicing accountants who were asked if they were influential in their clients decision to adopt the FRSSE and 90% said they were and 7% indicated that the were partially influential. There is very little evidence, worthy of including in this paper, of the reasons why directors of small firms and their accountants chose the FRSSE option. In conclusion, therefore, although the FRSSE is a significant popular reporting option for small companies it is not clear why this is the case.

3.4 Audit exemption

The EC Fourth Directive permitted national governments to dispense with the requirement for small companies to undergo an audit. In the UK, the government took advantage of this exemption. However, it did not adopt the full definition of a small company as defined in the Companies Act which reflected EC recommendations. Although, the definition was the same as the Companies Act for the value of assets and number of employees the turnover threshold was substantially less. Since 1994 when the concession was introduced periodically the turnover threshold has been revised upward. No explanation has been given for these revisions. Currently, the turnover threshold stands at £1m.

The difference in the turnover threshold adopted in the definition of a small company under the Companies Act and for the audit exemption implies that government see some benefit from the audit for a proportion of small companies at the higher turnover level which currently stands at £4.8m. The UK Government have recently published a consultation document, which states that the government 'is minded to increase the audit exemption threshold to the EU maximum of £5.6m' (DTI, 2003, p. 5).

The responses of practicing accountants indicate that 53% were of the opinion that the turnover threshold should be increased to £4.8m and 36% thought it should remain at £1m. The remaining 11% took the view that the threshold should be raised but not as high as £4.8m. However, 57% were of the opinion that one or more of their clients would continue to have a statutory audit if the threshold were increased to £4.8m. (The survey was carried out before the threshold was raised to £5.6m.)

The main reason why practising accountants were of the opinion that their clients would continue to want an audit is that banks and other providers of finance require clients accounts to be audited, to meet regulatory authorities requirements (for example, ABTA) and if the client company had external shareholders.

The research by Collis and Jarvis (2000) indicated that 63% of their sample of directors would continue to have their accounts audited even if they were exempt. The turnover threshold at the time of this survey was £4.2m. The main reasons they gave were the value they placed on having an independent check on the figures and/or confirmation of the financial position. At the time of this survey, majority of the directors did not want the threshold increased to £4.2m, and it is interesting that if it did increase a significant majority would carry on with the audit. This is a similar finding to the more recent research with practicing accountants.

The evidence from the accountants' survey (ACCA, 2003) and the directors' survey (Collis and Jarvis, 2000) supports the view that when a company's annual financial report is being used by external parties, the audit becomes a requirement because it improves the credibility and quality of the financial information contained in the annual report. For small companies where there is no external or insignificant external financial relationship with lenders or no regulatory requirement to have an audit, the directors are likely to take up exemption. In this case, it is likely that the directors perceive the cost of an audit exceeds any benefits.

The above analysis brings into question the relevance of purely quantitative thresholds being used as the criteria for determining whether small companies should be able to opt for the audit exemption. The demand for the audit is clearly being driven by parties outside the company, rather than the size of the company measured by turnover or any other quantitative criteria.

4. Development of an IFRS for small entities

The definition of what constitutes a small entity is complex and could particularly be a problem to the IASB in introducing an IFRS for small companies. There seem to be two options: to use either a quantitative or qualitative criteria. There may also be a case for using both. Quantitative criteria have been used in the UK following the EU recommendations. The focus has been on turnover, net asset values and the number of employees. These quantitative criteria however, tend to ignore the stakeholders and the demand for financial information. The argument in the case of the statutory audit in the UK points to the demand for the audit coming from three external bodies: banks, regulatory authorities and external shareholders. It would appear that quantitative measures have difficulty in capturing these users' needs.

There is also the question of public interest. This argument centres on the idea that the differentiation should be based on whether or not a company's business relates to the public interest. If it does, the argument proposes that there should be full disclosure of information and no option should be available to elect, what some would describe as, a lesser set of standards in terms of disclosure. Another important dimension for the IASB is that if they were to use quantitative criteria it is unlikely that it would capture similar economic aspects about countries worldwide. Simply a small company defined by say turnover in the US is unlikely to seen necessarily as small in a developing nation.

The UK case study shows there is a significant demand for differential reporting as reflected in the adoption of abbreviated accounts and the FRSSE by small companies. This begs the question why? Undoubtedly, cost is a significant factor for the adoption of differential reporting. UK government rhetoric emphasises cost burdens and it is generally accepted that the cost of producing the statutory accounts is proportionally higher for small companies vis-à-vis large companies. In terms of the FRSSE, there are likely to be marginal cost savings compared with producing financial statements under big GAAP. This is not, however, the case with abbreviated accounts, which are an additional set of accounts drawn from the full accounts prepared for shareholders. The cost dimension is also closely linked with complexity of standards and it follows financial reports. The 2003 edition of IFRSs has over 2,000 pages and the content of many of the standards is very complex. Therefore, it is likely that preparers and users of small company accounts would prefer a less costly and complex option.

Although, there is no empirical research supporting this view, there is anecdotal evidence to suggest that the take up of differential reporting options in the UK is a function of the availability of suitable software. There are now a number of off-the-shelf accounting packages that are designed on the assumption that directors of small firms will take the FRSSE and abbreviated accounts options. The IASB should bear this in mind if they are to introduce IFRSs for small entities.

The ASB and the IASB both refer to decision usefulness and understandability as objectives of financial reporting however, there is very little research examining these two aspects in terms users of small business financial reports. This problem must be addressed to inform standard setters in producing effective disclosure for these users.

The IASB have been very clear as to who they consider to be the main users of IFRS - the capital markets. Importantly, therefore, a theoretical framework can be constructed focusing on this user which gives underpinning to the development of individual accounting standards. The capital markets worldwide tend to have common needs in terms of financial information requirements. In a global context is not clear who the users of small businesses financial reports are. The users may differ and more importantly their information needs could also differ. The importance from a theoretical perspective of the knowledge of the users and their needs of small businesses financial reports could be a difficult gap in constructing IFRS for small companies. This aspect of the debate begs out for some sound informative research within this context agency relationships need to be carefully examined particularly with the wide group of creditors that small businesses are likely to have relationships with.

In the case of the UK FRSSE, a criticism cited was that it does not go far enough in terms of differentiation between entities of different sizes in order to meet the needs of users of small companies. Certainly, the only changes from the full standards are a reduction in disclosure requirements. There however, may be a strong argument, particularly from the complexity perspective, to introduce difference in some standards in respect to measurement and recognition. In contrast, some commentators argue that if there are changes in measurement and recognition it will be too greater deviation from the original standards to maintain credibility. The IASB must therefore address this issue.

Finally, from the UK case study, it is apparent that the external accountant is very influential in the election of differential reporting choices made by smaller entities. This is much less likely to be the case with large firms, who rely to a greater extent on internal experts. It is apparent from the UK case study and internationally that very little is known about the users of small business financial reports and their users. This means that any research that is commissioned by IASB regarding small companies and differential accounting elections it is important that these accountants are consulted.

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