



Small company abbreviated accounts: A regulatory burden or a vital disclosure?

John Kitching, Eva Kašperová, Robert Blackburn and Jill Collis



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A regulatory burden or a
vital disclosure?

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Foreword

Whilst the focus of financial reporting is directed predominantly at the requirements for large and listed companies, we should not lose sight of the needs of the vast number of small companies in the UK. Whilst limited liability status places an obligation on companies to file their accounts on the public record, for small companies there is an option to file abbreviated rather than full accounts. But what impact does this option have on users and preparers and what is the impact on the wider economy? Are abbreviated accounts fit for purpose?

In a recent government proposal it was suggested that requirements for 'micro' companies should be further relaxed. It is argued that reducing this burden would help small companies concentrate on growth. But what of the consequences of this proposed move on users of the accounts and the economy?

This study explores the views of preparers and users of small company abbreviated accounts using surveys and interviews to investigate opinion on the value of small company abbreviated accounts. A key theme to emerge from the study is the tension between the interests of small company preparers and the users of abbreviated accounts: the option to file abbreviated accounts is valued highly by small company directors, who wish to maintain confidentiality for business and personal reasons; perhaps not surprisingly, users prefer greater transparency and view abbreviated accounts as a constraint on decision-making, and argue strongly for the benefits of greater disclosure and against total exemption.

For policy-makers, there is a trade-off between reducing the regulatory burden on small companies and improving the transparency of financial information. Recent European Commission proposals suggest that deregulation may be favoured. The policy decision on the form of accounts required for small companies should be based on evidence and I hope that this report is useful to the ongoing UK government and European Commission and Parliament deliberations on this important issue.

This project was funded by the Scottish Accountancy Trust for Education and Research (SATER – see page 62). The Research Committee of The Institute of Chartered Accountants of Scotland (ICAS) has also been happy to support this project. The Committee recognises that the views expressed do not necessarily represent those of ICAS itself, but hopes that the project will add to the policy debate about future reporting by small companies.

Allister Wilson
Convener of the ICAS Research Committee
June 2011

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Finally, the Research Committee and the researchers are grateful for the financial support of the Scottish Accountancy Trust for Education and Research, without which the research would not have been possible.

Executive summary

Background and research objectives

This UK-wide study investigates the value of small company abbreviated accounts to preparers and accounts users. The findings are relevant to the debate surrounding recent European Commission (EC) proposals that would permit Member States to simplify accounting obligations for the smallest companies. Specifically, the Commission initially sought to exempt micro-entities, defined as companies not exceeding two of three criteria (a balance sheet total below €500,000, annual turnover below €1 million, and average employment of 10) from the Accounting Directives. The UK government subsequently indicated a willingness to use the micro-entity exemption to reduce the burdens on micro-companies. Under a new compromise package (announced on 31 May 2011), the EC has now proposed a reduction in the thresholds to a balance sheet total below €250,000, annual turnover below €500,000 and average employment of 10. This new package proposes simplified rules for profit and loss and balance sheet reporting requirements, with a requirement for simplified balance sheet information to be filed. The proposals will be considered by the European Parliament and have been welcomed by the UK government.

Limited companies in the UK are required by law to prepare financial statements giving a true and fair view of the company's financial performance and financial position for members and file a copy, in full or abbreviated form, at Companies House. Companies required to prepare full accounts must provide a balance sheet (statement of financial position) and a profit and loss account (income statement). Small companies filing abbreviated accounts must register an abbreviated balance sheet and related notes, but not a profit and loss account or other financial statements required of large companies.

Little evidence is available, however, regarding the views of preparers and, particularly, users of the utility of abbreviated accounts.

To contribute to the policy debate, this study addresses the following questions:

- Why do small company directors file abbreviated accounts?
- Who uses small company abbreviated accounts, and for what purposes?
- What are the advantages and disadvantages of abbreviated accounts to preparers and users?
- To what extent do users rely on the abbreviated accounts and what other sources of information do they use?
- What role do accountants play in the preparation, and use, of abbreviated accounts?
- What are the advantages and disadvantages to preparers and users, if the abbreviated accounts option was abolished and small companies were (a) obliged to file full accounts or (b) exempt from the statutory requirement to file accounts?

Prior research

A limited literature exists on small company decisions to file abbreviated accounts and on the users and uses of abbreviated accounts. Few studies provide evidence on: small company directors' motivations to file abbreviated accounts; the advantages and disadvantages of filing them; user characteristics and motivations; the circumstances of accounts use; and the perceived value of abbreviated accounts to users relative to other information sources. Furthermore, little is known about the role of accountants in decisions to file abbreviated accounts, or in client decisions to use them.

Quantitative survey approaches to understanding financial reporting practices dominate the literature. Yet, arguably, they provide limited insight into the motivational and process issues surrounding filing and using abbreviated accounts. The present study, therefore, incorporates a strong qualitative component in order to contribute fresh insights.

Research approach

Given the aims of the study and the various stakeholder groups with a direct interest, a multi-stranded research design was implemented. Data were collected using postal and online surveys, and face-to-face and telephone interviews.

Data were collected from: small company preparers and users of abbreviated accounts; accountants in practice; large and medium-sized organisations in the private, public and voluntary sectors; Companies House; finance and credit management professionals, including banks, commercial credit reference agencies and credit insurers; and a small business membership organisation.

Filing abbreviated accounts

The option to file abbreviated accounts is valued highly by small company directors. Maintaining confidentiality for business and personal reasons, and accountants' advice, are key influences on the filing decision. Filing abbreviated accounts can enable directors to portray the company as larger than its true size in order to win new business. Filing full accounts and the greater financial transparency required might enable stakeholders (competitors, suppliers, customers, employees) to exploit information to the detriment of small company directors. The potential disadvantages of filing abbreviated accounts in terms of lower sales and/or limited access to finance had not materialised for the small company directors interviewed.

Accountants in practice play an important role in small company decisions to file abbreviated accounts, either making the decision on their behalf, or informing them of the advantages and disadvantages of filing options. For many accountants, filing abbreviated accounts is the 'default' option for small company clients, recognising the confidentiality advantages. Although aware of potential disadvantages, accountants generally believed that the advantages outweighed the disadvantages for most small company clients.

Users of abbreviated accounts

Companies House sources suggest an estimated 935,000 abbreviated accounts are downloaded annually from their website. This figure is almost certainly an underestimate as many users access abbreviated accounts indirectly via third parties such as credit reference agencies.

Users of abbreviated accounts include small companies, large and medium-sized organisations in the private, public and voluntary sectors, accountants in practice, and finance and credit management professionals (banks, credit reference agencies, credit insurers). Users typically look at abbreviated accounts to monitor the creditworthiness, and financial position, of: existing and potential customers; suppliers; and competitors. This work is undertaken in order to decide whether they – or, for accountants in practice, their clients – should initiate, continue, terminate, or renegotiate relationships with particular companies. Users pay greater attention to companies whose directors have dubious reputations, or are unknown to them, to companies engaged on larger contracts or performing critical roles, and to companies where credit relationships are uninsured.

Accountants in practice use abbreviated accounts on behalf of clients and, to a lesser degree, for their practice's own requirements. Motivations include: identifying the directors of particular companies; assessing clients' competitors, with a view to developing a market strategy for the client; identifying possible acquirers for client companies; evaluating client investments in other companies; and for marketing purposes, to identify companies to approach with a view to becoming clients.

Accounts users consider abbreviated accounts valuable to conduct credit risk assessments and take credit decisions – but only up to a point! They provide *some* useful information on company balance sheets and equity, that also allow estimates of the value of items excluded from the accounts; key indicator trends can also be tracked over time. Used as a low cost and easily accessible filtering mechanism, abbreviated accounts are of value to users as an aid to deciding whether to increase, or discontinue, information search activity in relation to particular companies. Used in combination with other sources, they provide part

of the information ‘jigsaw’ that supports decision-making by suppliers, customers, competitors, accountants in practice and finance and credit management professionals.

Limitations of abbreviated accounts

There is a clear divergence of view between small company preparers and abbreviated accounts users, regarding the value of abbreviated accounts. Accounts users, particularly finance and credit management professionals, take a much more critical view. First, published accounts – both abbreviated and full – suffer from being out of date at the point of use. The Companies Act 2006 permits companies to file accounts at Companies House up to nine months after the financial year-end, which reduces the timeliness of the information. Users prefer real-time information, particularly in the aftermath of the 2008-9 financial crisis.

Second, users consider abbreviated accounts of limited value because they lack detail and offer limited financial transparency. Allied to this, there is some concern that filed accounts might not be accurate as Companies House does not verify the quality of accounts filed. For users, abbreviated accounts offer *some* benefits, they are ‘better than nothing’; but because of their limited information content, they are also a constraint on decision-making. One respondent described users of abbreviated accounts as ‘users under sufferance’, who use them only because they are accessible and cheap, rather than because they are entirely fit for purpose. All user groups approached – small companies; large and medium-sized organisations; accountants in practice; and finance and credit management professionals – were critical of abbreviated accounts. These constraints arguably impact small company preparers, who perhaps fail to win new business or obtain credit. Several users reported that small companies might remain unaware of these disadvantages of filing abbreviated accounts.

Third, scaled up to the macro, national level, credit constraints were argued to be a major barrier to economic growth as fewer transactions are undertaken, thereby restricting GDP. The wider economy suffers because poor information impedes efficient credit allocation and, as a

consequence, economic development. Limited accounts information encouraged finance and credit management professionals to err on the side of caution in their decision-making, with adverse consequences for small companies – as seekers/beneficiaries of finance, credit ratings, and credit insurance decisions. Greater financial transparency, in contrast, facilitates superior assessment of credit risk that, in turn, enables a more efficient allocation of credit throughout the economy, better supporting economic activity.

Accounts users' views on alternative filing scenarios

Users of abbreviated accounts were invited to comment on the likely consequences of two alternative filing scenarios: if the option to file abbreviated accounts was removed and small companies were (a) required to file full accounts; or (b) no longer required to file accounts at all. Users strongly argued for the benefits of greater disclosure and against exemption, insisting this would have wider economic benefits.

Users identified a number of disadvantages of small company exemption from filing any statutory accounts; none cited any benefits. In addition to aggravating the problem of limited transparency, users believed exemption might encourage financial indiscipline. Lacking any obligation to make information publicly accessible, small company directors might be encouraged to adopt unsound financial management practices. Such behaviour could lead to problems for small companies and undermine stakeholder confidence by increasing the risks of transacting business with them.

Conclusions and policy implications

A tension exists between the interests of small company preparers and abbreviated accounts users. Preparers prefer financial confidentiality; users prefer greater transparency. This tension is most evident among preparers who are also users of abbreviated accounts.

The paradox for small companies is that both confidentiality and transparency potentially serve their interests. Confidentiality protects

small companies from accounts users whose actions might harm them. At the same time, it limits the support that others – financiers, suppliers, credit reference agencies and insurers – might provide. Permitting small companies to file abbreviated accounts might, therefore, generate unintended, damaging consequences, although these might possibly be unknown to small companies themselves. Transparency potentially overcomes such consequences while at the same time making it easier for competitors and others to exploit financial information in a manner that might threaten small company performance. In the aftermath of the financial crisis, and the part played by poor credit risk assessment, the limitations of abbreviated accounts have become increasingly evident. There are signs that accounts users are demanding more detailed and timely information as a condition for supplying credit, credit ratings and insurance cover. Whether such a response is a temporary adjustment to the financial crisis and will loosen as economic circumstances improve remains an open question.

Accountants in practice play a key role in small company decisions to file abbreviated accounts and in client decisions to use abbreviated accounts. Their role as users on behalf of clients, many of whom are small companies, appears to be more important than using them for the requirements of their own practices. For many accountants, filing abbreviated accounts on behalf of small company clients is the ‘default’ option, to be departed from only in specific circumstances.

For policy makers, there is a trade-off between reducing the regulatory burden on small companies in order to try to stimulate growth and increasing the transparency of financial information in order to reduce business uncertainty, improve credit allocation, and facilitate economic development. Recent European Commission proposals, and supportive UK government statements, to exempt micro-entities from financial reporting obligations suggest that deregulation is favoured. But, reducing financial reporting obligations might produce unintended adverse outcomes. While potentially freeing up time for directors to focus on business development, deregulation might also aggravate the adverse consequences that flow from declining financial transparency. Some companies might adapt to a more relaxed reporting regime,

possibly following accountants' advice, by not filing accounts at all. For accounts users, this would be a retrograde step. In a highly risk-sensitive environment, businesses, financiers, credit reference agencies and insurers might be unwilling to trade, extend credit, provide satisfactory ratings and offer adequate insurance cover to small companies and those who trade with them.

It might be argued that many micro-companies do not benefit from financial disclosure. Many do not aim to grow or seek external finance, and trade mainly with businesses whose decisions are not influenced by credit reference agencies or insurers. Such companies would not, therefore, suffer unduly from lower levels of transparency. For these companies, reducing reporting obligations might potentially offer some benefits in terms of greater confidentiality and from time and cost savings arising from not filing accounts at Companies House. These gains seem likely to be marginal in relation to those associated with current levels of public disclosure. Potential customers and suppliers might be willing, for example, to do business with particular micro-companies but choose not to because they perceive the company as a credit risk on the basis of them not filing accounts. Yet micro-company directors might remain unaware of this, even where they would be willing, if approached directly, to disclose detailed accounts information. Moreover, stakeholders might perceive the absence of filed accounts as indicative of a wider problem of poor management, rather than simply a means of retaining confidentiality. One might propose, therefore, to retain the option to file abbreviated accounts and to resist the temptation to abolish micro-entities' current obligations.

1. Background and research objectives

This UK-wide study investigates the value of small company abbreviated accounts to preparers and accounts users. The main elements of the regulatory framework for financial reporting in the UK are company law, accounting standards and, for listed companies, stock exchange rules. UK company law incorporates EU directives and the requirement to make accounts available at a registry stems from the Fourth Company Law Directive (78/660/EEC). The rationale for public disclosure of financial information is that anyone dealing with a limited liability company should be able to see the financial statements. Member States are able to permit qualifying small entities in their jurisdictions to forgo the statutory audit, and those qualifying as small or medium to register less detailed abbreviated accounts¹ in place of the full statutory accounts that large companies are required to file.²

Limited companies are required by law to prepare financial statements giving a true and fair view of the company's financial performance and financial position for members and file a copy of the accounts, in full or abbreviated form, at Companies House. Companies required to prepare full accounts must provide a balance sheet (statement of financial position) and a profit and loss account (income statement). The balance sheet summarises the value of company assets, liabilities and equity on the last day of the accounting period. The profit and loss account summarises the revenue and expenditure over the accounting period.

Under the Companies Act 2006, a non-publicly accountable entity qualifies as small if it does not exceed any two of the following three size thresholds. Apart from newly incorporated entities, the conditions must have been satisfied in two of the last three years.

- Annual turnover £6.5 million
- Balance sheet total £3.26 million
- Average number of employees 50

This study focuses on *abbreviated* accounts published by small entities, including private companies and limited liability partnerships (both referred to as small companies in this report). Small companies filing abbreviated accounts must register an abbreviated balance sheet (statement of financial position) and related notes, but not a profit and loss account (income statement), or any of the other financial statements required of large companies. Shareholders' rights to full accounts are not affected if the company chooses to file abbreviated accounts.

This study investigates the value of small company abbreviated accounts to preparers and users by addressing the following research questions:

- Why do small company directors file abbreviated accounts?
- Who uses small company abbreviated accounts, and for what purposes?
- What are the advantages and disadvantages of abbreviated accounts to preparers and users?
- To what extent do users rely on abbreviated accounts and what other sources of information do they use?
- What role do accountants play in the preparation, and use, of abbreviated accounts?
- What are the advantages and disadvantages to preparers and users, if the abbreviated accounts option was abolished and small companies were (a) obliged to file full accounts or (b) exempt from the statutory requirement to file accounts?

The study findings are relevant to the European Commission's proposal to allow Member States to simplify financial reporting obligations for the smallest companies (Commission of the European Communities 2009). The Commission initially sought to exempt micro-entities, defined as companies not exceeding two of three criteria (a balance sheet total below €500,000, annual turnover below €1 million and average employment of 10) from the Accounting Directives. The UK

government subsequently expressed an interest in pressing for exemption from financial reporting obligations for micro-companies to produce specific accounts for Companies House, as well as the tax authorities (HM Treasury, 2011). Under a new compromise package (announced on 31 May 2011) the EC has now proposed a reduction in the thresholds to a balance sheet total below €250,000, annual turnover below €500,000 and average employment of 10. This new package proposes simplified rules for profit and loss and balance sheet reporting requirements, with a requirement for simplified balance sheet information to be filed. The proposals will be considered by the European Parliament and have been welcomed by the UK government. If the Commission's proposals are accepted, Member States will be able to introduce their own national reporting regimes for micro-entities.

Chapter two reviews the literature on filing and using accounts filed by small companies. Chapter three outlines our methodological approach. Chapters four to seven present the findings regarding the filing and use of abbreviated accounts, the limitations of abbreviated accounts, and accounts users' views on alternative filing scenarios. Chapter eight draws conclusions.

2. Prior research

In 2009/10, approximately 3% of the annual accounts registered in the UK were categorised as ‘abbreviated – small’ (Companies House 2010: Table F2). The ‘audit exempt’ category, comprising 70% of accounts filed, includes many small companies filing abbreviated accounts, as these are also exempt from the statutory audit. Other sources estimate, or suggest, that 50-60% of companies in the UK file abbreviated accounts (Jarvis 1996; SERT/POBA 2005; POBA 2006). Awareness of filing choice is incomplete (Collis 2008) and negatively associated with company size (SERT/POBA 2005).

Abbreviated accounts offer benefits for small companies, including reduced disclosure of commercially sensitive financial information and directors’ emoluments (Collis and Jarvis 2000; POBA 2006; Marriott *et al.* 2006). Influences on financial reporting practices include business size (Collis and Jarvis 2000; SERT/POBA 2005; Eierle 2008), private equity ownership structures (Beuselink and Manigart 2007; Beuselink *et al.* 2009), high levels of competition (Dedman and Lennox 2009) and the role of accountants (POBA 2006). Such quantitative survey studies are *suggestive* of causal connections, but qualitative data on directors’ motivations for filing choices is required to substantiate such claims.

Most studies of users of small company financial statements do not distinguish between full and abbreviated accounts; we could find no studies specifically investigating the use of abbreviated accounts. The main external users of small company financial statements are lenders and tax authorities (Page 1984; Carsberg *et al.* 1985; Barker and Noonan 1996; Pratten 1998; McMahon 1999; Collis and Jarvis 2000; Collis 2008) – who use them to assess lending and credit risk (Stanga and Tiller 1983; Berry *et al.* 1993, 2004; Roberts and Sian 2006; Bruns and Fletcher 2008), or to assess tax liability (Carsberg *et al.* 1985; Collis and Jarvis 2000). Small company directors themselves read competitors’, customers’, and suppliers’/creditors’ financial statements (Collis and Jarvis 2000; Pratten 1998). Whether users find *abbreviated* accounts useful is not known.

Financial information-seekers use other sources in addition to registered accounts. Lenders, major suppliers and customers possess the power to request more detailed accounts directly from companies (Berry *et al.* 2004). Lenders often make the supply of funding conditional upon the provision of financial information (Marriott *et al.* 2006). Again, whether, and how, interested parties use small company *abbreviated* accounts is unknown. Accountants often help small company directors interpret financial statements (John and Healeas 2000; Collis and Jarvis 2000) but little is known with regard to abbreviated accounts.

The literature on small company *abbreviated* accounts suffers from a number of weaknesses. First, few studies provide evidence on small company directors' motivations to file abbreviated accounts or the advantages and disadvantages of doing so. Second, there is a limited literature on *users* of abbreviated accounts: their characteristics and motivations; the circumstances of accounts use; or the perceived value of abbreviated accounts relative to other information sources. Third, while studies recognise the important role accountants play as providers of financial and management advice to small companies, little is known about their role in decisions to file abbreviated accounts, or in client decisions to use them. Fourth, quantitative survey approaches to understanding financial reporting practices dominate the literature but provide limited insight into the motivational and process issues surrounding filing and using abbreviated accounts. This study, therefore, incorporates a strong qualitative component in order to contribute fresh insights.

3. Research approach

To address the research objectives, and given the various stakeholder groups with a direct interest, a multi-stranded research design was implemented. Data were collected from a diverse range of sources using postal and online surveys, face-to-face and telephone interviews (Table 1).

Table 1 Respondent groups

Data source	Survey sample	Interview sample
Small company preparers/users of abbreviated accounts	149	12
Accountants in practice	255	10
Organisational accountants	159	10
Other accounts users and intermediary bodies	-	18

- *Small company preparers/users of abbreviated accounts* – a postal survey response from 149 small company preparers of abbreviated accounts. A stratified random sample of 2,750 companies was drawn equally from three areas (London, Scotland, and the rest of England and Wales) from the FAME database.³ Questionnaires and FREEPOST envelopes were distributed to named company directors. The achieved response rate was approximately 5%. Follow-up interviews with 12 respondents who were also users of abbreviated accounts sought to investigate, in more depth, directors’ motivations and the circumstances surrounding filing/using decisions.
- *Accountants in practice* – an online survey response from 255 accountants, drawn from the ICAS membership database. 964 ICAS members were invited to participate (27% response rate). Follow-up interviews with 10 abbreviated accounts users investigated in depth the role of accountants in decisions to file, and use, abbreviated accounts, either on behalf of clients or for their practice’s own requirements.

- *Organisational accountants* – an online survey response from 159 accountants in large and medium-sized private, public and voluntary sector organisations, drawn from the ICAS membership database. 1,208 ICAS members were invited to participate (13% response rate). Follow-up interviews with 10 abbreviated accounts users investigated motivations for, and circumstances of, accounts use.
- *Other accounts users and intermediaries* – interviews were conducted with senior managers or officials in 18 organisations, including banks, commercial credit reference agencies and credit insurance companies (Table 2). Approaches were made to approximately 50 organisations.

Table 2 Accounts users and intermediaries - interviewees

Interview code	Type of organisation
1	High street bank
2	Professional finance sector membership body
3	Companies House
4	Finance sector trade association
5	Credit reference agency
6	Credit insurer
7	Credit insurer
8	Credit reference agency
9	Credit reference agency
10	Credit reference agency
11	Finance sector lobby group
12	Credit insurer
13	Small business membership organisation
14	Credit insurer
15	High street bank
16	Trade credit insurance broker
17	Public sector organisation
18	Public sector organisation

Statistical significance testing is undertaken ($\alpha = 0.10$). We now turn to the empirical findings, commencing with small company preparers of abbreviated accounts before examining accounts users.

4. Filing abbreviated accounts

The small company survey sample varied in terms of key size indicators, in-house financial sophistication and performance. The vast majority of companies had an annual turnover of less than £830,000 (85% of the small company sample) and employed fewer than 10 people (81%).⁴ A third of the sample (34%) employed a qualified accountant. Approximately 32% of companies reported higher profits in the last financial year than in the previous one, with 46% reporting similar profits, and 20% declining profits. The small company interview sample was also skewed towards micro-companies: nine of the 12 employed fewer than ten people.

Motivations to file abbreviated accounts

The two most common reasons for filing abbreviated accounts cited in the literature are: (a) to avoid public disclosure of sensitive business information; and (b) to follow accountants' advice (Collis and Jarvis 2000; POBA 2006). These findings are strongly supported by the small company survey data. 'Following accountants' advice' was cited as the main reason by 65% of respondents, and 'avoiding public disclosure' by 26%.⁵ Those reporting rapid or moderate growth aims were more likely to give reduced disclosure as the primary reason for filing abbreviated accounts ($p=0.006$) whereas those reporting non-growth aims were more likely to report following accountants' advice ($p=0.046$). Motivations for filing abbreviated accounts were *not* associated with company size (turnover, employment), performance (net profit, employment change) or financial sophistication (employment of an in-house accountant), suggesting that directors' rationales for filing were relevant to a wide range of small companies.

In interview, small company respondents emphasised filing the legally prescribed minimum requirement in order to avoid disclosure of financial information. Maintaining confidentiality – from competitors, customers, suppliers and employees – is believed to facilitate greater control over the terms of stakeholder relationships, securing new

business and concealment of personal income. Respondents were keen to avoid disclosing information that might be used against them. Prospective competitors, for instance, might be attracted to the company's markets if they believe there are good profit margins to be made; this is easier to identify in smaller companies with fewer product lines. Suppliers, employees and customers might seek to obtain higher supply prices, wages and salaries, or discounts, if they believe the company is successful.

It was really to stop competitors finding out about us... My concern, for instance, with full accounts is that my competitors can find out my gross margins, which I don't want them to know. (Company 11: wholesaler, 3 employees)

It was unnecessary for us. We didn't need to file full accounts... [The owners] don't particularly want to publicise what we're doing and how well we're doing. I think that was the key driver in terms of filing abbreviated accounts. It was keeping things private. There's no sense in letting suppliers work out how well we're doing. (Company 8: kitchenware wholesaler, 26 employees)

For example, we wouldn't particularly want our staff to know what the directors' remuneration was or any of that kind of thing. The less information we can lodge to meet our requirements is the way to go as far as we're concerned. (Company 10: flooring contractor, 11 employees)

Several respondents reported presenting the company as appearing larger than its true size in order to win business from clients cautious to award contracts to small companies. Filing abbreviated accounts enabled companies to conceal their size.

If you're working with large companies and people start pulling your accounts and saying, 'Oh they only turned over 100 grand! We'd best not give them this order for 5,000 envelopes'. The public availability

of information damages people. (Company 5: mail service, 5 employees)

Small company directors might choose to file abbreviated accounts in order to conceal decisions to reduce profit and tax liability, which accounts users might interpret as an indicator of poor performance. One respondent, the owner of two companies, reported a decision to reduce the scale of operations in one, while developing the other.

I didn't want people to see that the profits were going to be dropping ... So it sounded to me that it would be a good idea... from that point of view, not to reveal so much, bearing in mind that we would be showing a sharp drop in the curve and anybody that might be sensing this for credit rating purposes might go 'That doesn't look so good'... It's not really that the company is less profitable. It's because we've made a decision to pay less tax. (Company 2: business information services, 4 employees)

In small companies, maintaining confidentiality is a means of keeping *personal* income details private too. Accounts users might be able to estimate directors' personal incomes where there are few directors or other staff.

[Full accounts] would give more information to competitors, for one thing, but also because it's a private company – so, essentially, just myself and my wife, who are the directors – it would give a great deal of information about our personal finances to the outside world which I don't want them to know about. (Company 3: tax consultancy, 2 employees)

Small companies might suffer disadvantages from filing abbreviated accounts, including failing to win orders, access bank finance or obtain adequate credit ratings. In interview, none of the 12 respondents reported losing customers or being unable to access sufficient finance because they filed abbreviated accounts. It might be argued, however, that small

company directors are simply unaware of the reasons for failing to win new business or to access finance, where these events occur. All small company respondents claimed to have access to internal or external finance to fund current operations and future plans. Most claimed that if major lenders, suppliers or customers requested more detailed and up-to-date management accounts, they were willing to provide them.

I have no evidence to suggest that we've ever lost business, or we've ever failed to raise funding, as a result of filing limited accounts... I have no recollection in the 14 years of being in business of a time when we've lost a piece of business as a result of filing limited accounts... I can say that there have been occasions when I've probably won business because people have no idea how small we are. (Company 5: mail service, 5 employees)

Interviewees were asked whether they had, or might consider, filing full, rather than abbreviated, accounts. Most claimed they would only consider filing full accounts where they were legally obliged to do so; others indicated they would consider doing so prior to company sale.

If I ever got to the situation where – it probably won't happen for another five years or so – we wanted to look at selling the company off, or to be taken over by somebody else, then I think there'd be an attraction in providing more detail at that stage. Again, it provides more comfort to those who may be interested in taking us over that we are a proper set-up. (Company 7: project and programme management services, 2 employees)

To sum up, the survey and interview data from small company respondents provide clear evidence that the option to file abbreviated accounts is valued highly by small companies. Maintaining confidentiality and accountants' advice were cited as key influences on the filing decision. The potential disadvantages of filing abbreviated accounts in terms of lower sales and/or limited access to finance had not materialised for the small company directors interviewed.

The role of accountants in filing decisions

As discussed earlier, two-thirds of surveyed small companies reported accountants' advice as the *primary* reason for filing abbreviated accounts. Most respondents (92%) reported discovering the option to file abbreviated accounts from an accountant, and 78% discussed the advantages and disadvantages of filing options with their accountant when making filing decisions. One director reported being unaware of the different filing options prior to switching accountants:

I was under the impression before that your accounts are filed every year, that's the way you have to do it, because that's how my old accountant, who was nearing retirement age, had always done it. So I didn't really know that was an option, to be honest. (Company 2: business information services, 4 employees)

Accountants in practice concurred that their role in small company clients' decisions to file abbreviated accounts in the past year was proactive. Almost two-thirds of accountants suggested the idea of filing abbreviated accounts to small company clients, with a further quarter of the sample informing clients of the potential advantages and disadvantages (Table 3).

Table 3 Role of accountants in small company filing decisions

	% of sample
Usually, I suggest the idea of filing abbreviated accounts to qualifying small company clients if I consider it appropriate	64.2
Usually, I inform qualifying small company clients of the potential advantages and disadvantages of filing abbreviated accounts and let them decide	26.3
Usually, I play no role in the filing choice of small company clients	3.8
No data	5.8
Number of respondents	240

Note: percentages do not sum to 100 due to rounding

Base: accountants reporting filing abbreviated accounts on behalf of small company clients

For many accountants, filing abbreviated accounts is the ‘default’ option for small company clients. Of accountants with small company clients, 71% reported that *all* small company clients filed abbreviated accounts in the past year, attributing the decision to reduced public disclosure (reported by 81% of the accountants in practice sample) while downplaying their own influence (13%). Accountants suggesting the idea of filing abbreviated accounts to clients were significantly more likely than those who did not suggest this to respond that *all* small company clients filed abbreviated accounts ($p=0.001$). This suggests accountants’ advice regarding filing options is largely accepted by small company clients.

In contrast to the small company survey data, interview evidence suggests that small companies adopt a proactive approach to filing. Most small company interview respondents reported a preference for filing abbreviated accounts, or to ask accountants’ views of the potential benefits and disadvantages of different filing options, rather than deferring to them to make the choice on their behalf. Interviewees presented themselves as knowledgeable and confident regarding filing options, arguably more so than the majority of the small company survey sample who filed, but did not use, abbreviated accounts.

Accountants in practice clearly believed the abbreviated accounts option was of great benefit to small companies. Accountants were asked, ‘what impact would the removal of the option to file abbreviated accounts have on small company clients?’ and invited to respond in terms of five response categories (major adverse impact; minor adverse impact; no impact; minor favourable impact; and major favourable impact): 73% reported small company clients would suffer an adverse impact if the option was removed. Only 4% anticipated a favourable impact, with 18% expecting no impact. Accountants agreed with small company respondents that abbreviated accounts provided valuable confidentiality and that requiring full accounts would enable competitors, and others, to discover turnover and profit margins, directors’ remuneration, dividends and other information. Greater disclosure might place small companies at a disadvantage, not only from larger competitors, with greater resources to exploit financial information, but also from unincorporated

rivals (sole proprietorships and partnerships) that do not face similar obligations. Some accountants suggested that many business owners had incorporated in order to obtain limited liability protection and that removal of the option to file abbreviated accounts would be unfair, and might lead to ‘disincorporation’ or deter others from incorporating in future.

I think the small companies who are thinking about their structure, they would be less happy if, for example, their profits that they are making and their dividends that they are taking out... and much more information [were disclosed in public], I think that would have an impact on them forming companies. (Accountant 5: 14 employees)

Interview data showed that accountants often recommend filing abbreviated accounts to small company clients in particular circumstances, for example, where the results demonstrate poor, or declining, performance or where directors want to portray the company as larger in order to win business. Accounts users might be critical of such behaviour but, in the context of legal and professional codes requiring accountants to act in clients’ best interests, such action is justifiable in supporting clients as *preparers* of accounts. Conversely, accountants often recommend filing full accounts where companies have ‘nothing to hide’ or where directors are concerned to achieve a higher credit rating.

Summing up, the evidence demonstrates that accountants play an important role in small company decisions to file abbreviated accounts, either making the decision on their behalf or informing them of the advantages and disadvantages of filing options. Accountants believed that filing abbreviated accounts was the appropriate option for the vast majority of small companies, recognising the confidentiality advantages. Although aware of potential disadvantages, including poorer credit ratings, accountants generally believed that the advantages outweighed the disadvantages for most small companies.

5. Users of abbreviated accounts

Little data is publicly available on the extent of abbreviated accounts use, the identity of abbreviated accounts users, the motivations for, and circumstances of, use, or user perceptions of the value of abbreviated accounts as a source of information. Companies House data sources permit an estimate of abbreviated accounts use. Such sources, admittedly broad-brush, suggest 935,000 abbreviated accounts are downloaded annually from the Companies House website.⁶ This figure is almost certainly an underestimate of abbreviated accounts use as many users access accounts indirectly via third parties such as credit reference agencies. It is not possible, however, to estimate the number of indirect accounts users. Companies House provides no data on type of user, or user motivations for accessing information.

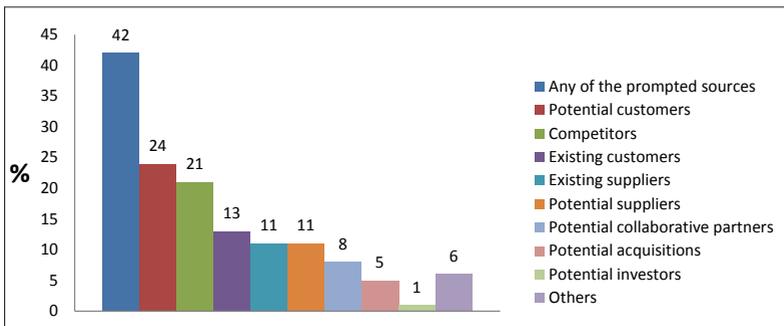
Companies House is a low cost, readily accessible data source on abbreviated accounts. Information is supplied *without the target company's knowledge*, which might be particularly important where a company is considering acquiring another. The Webcheck service, enabling access to filed accounts information, costs £1 per item and the more comprehensive Companies House Direct subscription search service costs £5 per month. In this section, we present data from a range of abbreviated accounts users including small companies, large and medium-sized organisations in the private, public and voluntary sectors, accountants in practice, and finance and credit management professionals.

Small company users

Prior research has indicated that small company directors are often users of others' published accounts (Collis and Jarvis, 2000). Small company survey respondents were asked if they used other small companies' abbreviated accounts: 42% reported doing so, primarily those of potential customers and competitors (Figure 1). Small company abbreviated accounts users were significantly more likely than non-users

to report: use of alternative sources of information ($p < 0.001$); rapid or moderate business growth objectives, rather than non-growth aims ($p = 0.009$); annual turnover higher than £830,000 ($p = 0.018$); employment of an in-house accountant ($p = 0.057$); and a decline in employment during the past two years ($p = 0.058$). Users would, therefore, appear to be keen information-seekers, larger small businesses, keen to expand, with in-house accounting expertise and experiencing employment decline. No significant associations, however, were found with other measures of company size (employment, net profit), age, number of shareholders, or behaviour (source of competitive advantage, exporting).

Figure 1 *Whose abbreviated accounts do small companies use?*



Base: small company survey (n=149)

Most small company users are *restricted* users of abbreviated accounts: 80% reported fewer than 10 uses in the past year (68% report five or fewer), with 20% being *regular* users, with 10 or more uses in the past year (5% report 50 or more). Some regular users read abbreviated accounts routinely. For them, checking the financial viability of new customers and suppliers is standard procedure. Regular users were significantly more likely than restricted users to report: employment decline in the past two years ($p = 0.034$); annual turnover greater than £830,000 ($p = 0.063$); rapid or moderate business

growth objectives (0.066); employing 10 or more people ($p=0.068$); and lower net profit margins (0.097).⁷ Interestingly, no significant correlation was found with employing an in-house accountant. Together, such data indicate that larger small firms seeking to expand, but experiencing lower profit margins and employment decline, are more likely to be regular abbreviated accounts users, perhaps indicating a heightened sense of vulnerability, and consequent need to acquire information prior to entering new business relationships, following the 2008-9 crisis.

With any new customer, as part of our standard operating procedure, we would look at abbreviated accounts and we would make a judgement, along with any other credit rating information we can get on them, as to how big their credit limit should be ... Accounts tell me a little bit about the history of that company, its growth prospects and all sorts of other things. (Company 1: printing services, 50 employees)

Given the sample size and composition, perhaps too much weight ought not to be attributed to the precise proportions using particular types of accounts; the data might, however, indicate their relative importance. Small company respondents use abbreviated accounts to assess the creditworthiness, and financial position, of key stakeholders, including existing and potential customers, competitors and suppliers (Figure 1). Such accounts data informs decisions to initiate, continue, terminate or renegotiate the terms of relations with other companies.

We charged [a new customer] 50% up front because of their abbreviated accounts... We'd already decided we liked them. We'd already decided we could do a good job for them and could save them money. But, unfortunately, their accounts didn't stack up... We just went back to them and said 'hey guys, we'll take 50% up front'. They said 'oh we get credit elsewhere'. I guess they don't get credit elsewhere because they came back and said 'ok, here's a cheque'. (Company 5: mail service, 5 employees)

Abbreviated accounts provide some useful information on company assets, liabilities and equity. The abbreviated balance sheet (statement

of financial position) provides information about equity that permits users to estimate profit for the period in the absence of a profit and loss account (income statement). Trends in key financial indicators, where information about financial position is disclosed in the balance sheet, can also be tracked over time, subject to difficulties establishing why changes have occurred.

One respondent reported a dispute with a client company over payment. The respondent discovered that the client was financing property development projects from company reserves at the same time as delaying payment. This galvanised the respondent into pressing for payment and, subsequently, terminating the relationship.

That's when I obtained a set of the accounts and had a look through. That's when I found out that he had taken several hundred thousand pounds of loans out... of his own company during the same period that we weren't being paid by him. And the balance did not look that healthy from the previous year. So that started to send signals of concern and eventually I decided to end my association with him. (Company 7: project and programme management services, 2 employees)

For some companies, financial services providers, the analysis of financial statements, including abbreviated accounts, constituted part of the service provided to clients, for example, to determine whether a potential acquirer was genuine:

I also look at abbreviated accounts when sometimes outside businesses are looking to acquire business from one of my clients so that I can see whether they've got any substance behind them – or whether they are just, perhaps, time-wasters who are trying to find out information. (Company 3: tax consultancy, 2 employees)

For many abbreviated accounts users, Companies House is the 'starting point' for enquiry. Interview respondents reported scrutinising accounts filed at Companies House, whether abbreviated or full, as a preliminary, or filtering, phase in business decision-making. Filtering

involves search of easily accessible sources like Companies House and company websites prior to consulting other data sources, or to decide whether further search is necessary. Subsequent search involves approaching companies direct to request more detailed, up-to-date information or accessing third party sources such as credit reference agencies. Small companies, however, may lack the resources to persuade prospective customers to provide such information, or to obtain it from credit reference agencies, and are thereby more dependent upon publicly available sources.

If step one, when I saw abbreviated accounts, showed a balance sheet that had got historic profits rather than losses, and consistent growth and shareholder funds that were increasing year on year, then I would feel relatively comfortable without going to stage two. If, on the other hand, there were anomalies within the abbreviated accounts, then that would encourage me to go to stage two. (Company 1: printing services, 50 employees)

It's part of the jigsaw. It gives us context. Would I ever take someone on just based on them? No, I wouldn't. It's one of the tools in the tool-box and we like to use as many tools in the tool-box as we can to make an informed decision. (Company 5: mail service, 5 employees)

Small company respondents' attitudes towards using abbreviated accounts vary. Four in 10 (41%) reported they would like to use such accounts more often than they do. Those expressing such a preference were more likely to report: rapid or moderate business growth objectives ($p=0.004$); already being a user of such accounts ($p=0.015$); using alternative sources of information ($p=0.022$); being a restricted, rather than a regular, user of abbreviated accounts ($p=0.051$), suggesting barriers constrain further use; and employment of an in-house accountant ($p=0.057$). Barriers to further use include: time/effort required (reported by 41% of those wishing to use such accounts more); Companies House fees (38%); and accountants' fees (8%). No significant associations were

found with measures of company size (employment, turnover), net profit or employment change.

A large minority of surveyed small companies used abbreviated accounts, although the percentages reported might reflect the composition of the particular sample rather than being typical of the UK small company population. For some small companies, reading published accounts, both abbreviated and full, is routine practice when deciding whether to embark on, continue, terminate or renegotiate particular business relationships. Abbreviated accounts are used primarily as an easily-accessible, low-cost filtering tool to aid decision-making, or to decide whether further information search is necessary.

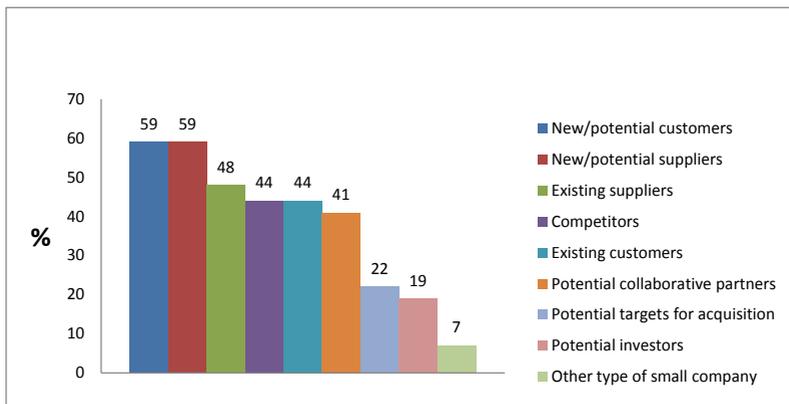
Organisational accountants

The organisational accountants sample, all Chartered Accountants, varied in terms of the legal status, size and principal business activity of their employer. Most worked in private limited companies (61%), with others employed by public limited companies (23%), not-for-profit/voluntary sector organisations (8%), public sector organisations (5%) and unincorporated businesses (3%). Organisational size ranged up to multinationals employing 285,000 people. Respondents worked for large organisations, employing 250 or more people (42%), medium-sized (50-249 employees) (30%) and small organisations (up to 50 employees) (28%), including 7% in micro-organisations (fewer than 10 employees). Organisational accountants worked in a diverse range of sectors, mainly manufacturing (15%), professional, scientific and technical activities (14%), and finance and insurance (10%).

Only 27 of the 159 organisational accountants (17%) reported using abbreviated accounts; the small sample should be borne in mind when interpreting the results presented. Organisational accountants were asked which of three statements best described their involvement in decisions to use abbreviated accounts in the past year. Most commonly, respondents reported either making the decision or suggesting the idea to decision-makers within the organisation (59%); only 19% reported simply carrying out decision-makers' instructions.

Most organisational accountants were *restricted* users of abbreviated accounts: 56% of users reported fewer than 10 uses in the past year (37% reported five or fewer). Conversely, 37% were *regular* users, with 10 or more uses in the past year (7% reported 50 or more).⁸ Organisational accountants used the abbreviated accounts of various stakeholders, primarily those of new/potential customers and new/potential suppliers (Figure 2).

Figure 2 Organisational accountants: whose small company accounts do they use?



Base: organisational accountants reporting using small company abbreviated accounts (n=27)

In interview, organisational accountants reported checking on new customers and suppliers as routine business practice, especially where exposure to risk was perceived to be high. Perceptions of risk related to contract size, strategic importance, extent of credit insurance cover and prior relations, with larger contracts, stakeholders performing critical roles, uninsured credit relationships and previously unknown companies attracting greater attention.

If it was a company that was going to be a key supplier to us, then I would ask for further information. If it was a potential acquisition...

I would always ask for further information. If it was a supplier... that we wouldn't have a longer relationship with, and we weren't going to spend a lot of money with, provided that there was nothing in the abbreviated accounts that made me sit up and wonder, I would probably just continue to use those. (Organisational accountant 1: restaurants/cinema, 150 employees)

If the order is less than £30,000, that's within my discretion limit as far as the credit insurers are concerned. I must satisfy myself and then prove to the credit insurers that they are good for that level of cover... If it's more than £30,000 and there's no credit cover available, then I'll pull up that set of accounts and just do my own assessment. We will take a commercial view based on the financial accounts. (Organisational accountant 9: construction, 80 employees)

The 2008-9 crisis has influenced businesses to adopt a more cautious stance towards trading partners, even if they were already known to the organisation. Once-reliable customers and suppliers are perceived as higher risk than previously.

We do it, given the current state of the market-place at present... I looked recently at some glass companies who are supplying to us. Glass is a major component of our production process... whilst we have tended to use [major companies], some of the smaller companies are offering some fantastic deals. That is where our competition is sometimes getting a lead. So, our view was 'while it's riskier, we've got to go and vet them and consider them'. I did that on a couple of existing suppliers to see whether or not we could increase the level of order. (Organisational accountant 9: construction, 80 employees)

Organisational accountants used abbreviated accounts as a filter to determine whether additional information from companies direct, or business references, was required. Abbreviated accounts alone might eliminate the need to undertake additional information search, by ruling out certain possibilities – but were unlikely to enable stakeholders to

conclusively reach a major decision; this would require examination of a range of information sources.

[Abbreviated accounts] would only give us enough information in a negative sense. Sometimes you look at the abbreviated accounts and realise that there is no point in getting any further information because we don't want to do any business with them. It's unlikely to give us enough information in a positive sense. We would always then have to go and get further information... We do look at potential targets [for acquisition]. Now obviously, we wouldn't base that decision purely on the abbreviated accounts, but it would be a good indicator of something that was worth buying. And then we would ask the company for more detailed information. So, again, it would be early stage information. (Organisational accountant 3: logistics, 1800 employees)

Organisational accountants vary in their attitudes towards using abbreviated accounts; most would not use them more than they do and only 15% reported they would like to do so. Most reported that other sources of information are easier (or as easy) to obtain (40%), while others reported lack of detail in abbreviated accounts, as reasons for requiring no further use.

Only a small minority of organisational accountants reported using abbreviated accounts. This makes it difficult to generalise on the basis of the survey findings with confidence. The interviews provide a stronger grounding for claims regarding user motivations, the circumstances of use, and accountants' evaluations of the value of such accounts as an information source. Abbreviated accounts are a cheap, easily accessible source of financial information that permit preliminary assessments but which require supplementing with other, more detailed, sources to contribute to decision-making.

Accountants in practice

Accountants in practice, all Chartered Accountants, varied in size from one-person businesses to multinational operations with 3,000 employees. Most practices were micro (74% of the sample) or small businesses (18%). Accountants were asked which of three statements best described their involvement in client decisions to use abbreviated accounts in the past year. Most commonly, accountants reported suggesting the idea to appropriate clients (43%) (Table 4). Interview data suggested that accountants often responded to client requests to look at particular company accounts *and* also proactively sought such information without a specific client request.

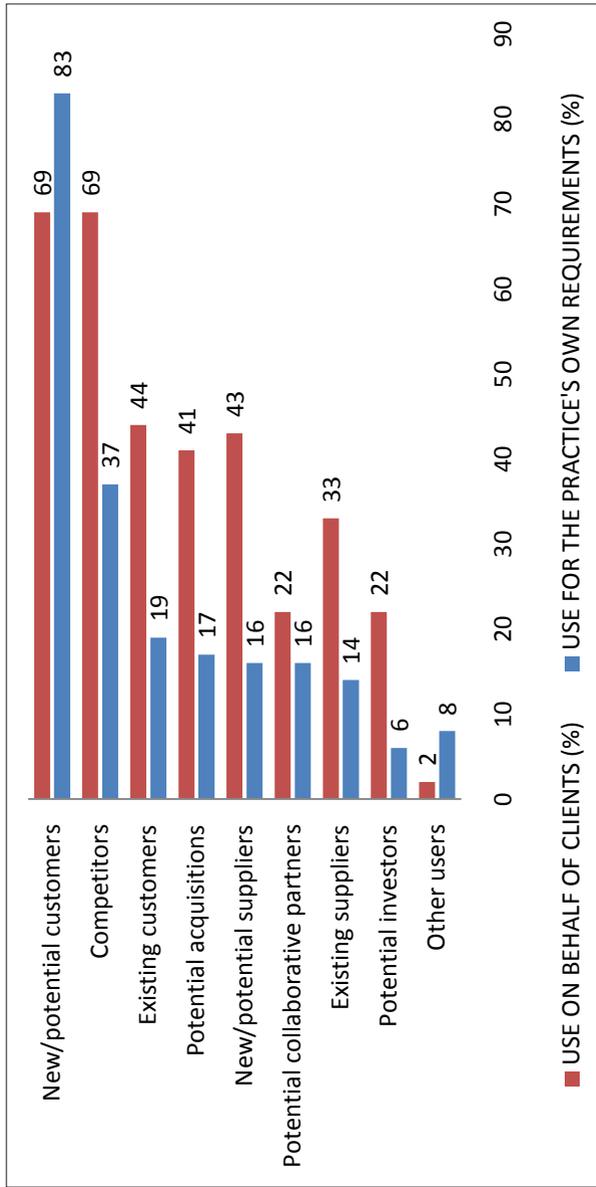
Table 4 Role of accountants in the use of small company abbreviated accounts

	% of sample
Usually, I suggest the idea of using abbreviated accounts to appropriate clients	42.9
Usually, I inform clients of the potential advantages and disadvantages of using abbreviated accounts and let them decide	28.6
Usually, I play no role in client decisions to use abbreviated accounts	5.8
Other responses	7.8
No data	14.9
Number of respondents	154

Base: accountants reporting using abbreviated accounts on behalf of clients

Accountants in practice use abbreviated accounts for their own requirements (35% of the sample), and/or on behalf of clients, who may or may not be small companies themselves (53%) (Figure 3).

Figure 3 Accountants in practice: use of small company abbreviated accounts



Base: (a) accountants reporting use of abbreviated accounts on behalf of clients (n=135); (b) accountants reporting use of abbreviated accounts for the practice's own requirements (n=90).

Of accountants using abbreviated accounts, new/potential customers was the only source reported by more than half from both groups, although 69% of accountants using abbreviated accounts on behalf of clients reported reading *clients'* competitors' accounts. With the exception of new/potential customers (and the 'other' category), accountants were more likely to use abbreviated accounts on behalf of clients than for their own practice's requirements.

Most accountants in practice are *restricted* users of abbreviated accounts. Of those providing data, 69% reported fewer than 10 uses in the past year (47% reported five or fewer), while 31% reported 10 or more uses (3% reported 50 or more).⁹ No significant association with size of practice was found.

Qualitative data from interviews with accountants suggested a range of motivations for using abbreviated accounts, either on behalf of clients or for the practice's own requirements: evaluating and monitoring companies' financial position/credit status, in order to decide whether they, or clients, should initiate, continue, terminate or renegotiate relations with particular companies; identifying the directors of particular companies; assessing clients' competitors, with a view to developing a market strategy for the client; identifying possible acquirers for a client company; evaluating client investments in other companies; and for marketing purposes, to identify companies to approach to become clients. Accountants reported that monitoring companies needed to be undertaken continuously, particularly when trading conditions are changing rapidly, as in recent times.

There are three things I think I can use the abbreviated accounts for. Number one, I can tell if they've got cash in the bank. Number two, I can tell if they've got net assets rather than liabilities. And number three, I'm able to tell if they've got any secured liabilities. But, often, you don't know if they've actually been prepared properly. Although you are meant to show secured liabilities in abbreviated accounts, I do wonder how many accounts get submitted without showing that.
(Accountant 8: 4 employees)

If a customer came along and said ‘we want to buy an appliance from you’, we would credit check that customer as a matter of course. That would either involve us using a credit agency or we’d source the accounts directly from Companies House – or maybe a combination of [both]. We would then do an internal assessment on the strength of these accounts and decide whether to supply that customer. If their credit system was poor, we would look for a deposit or an up-front payment from that customer. (Accountant 10: 1 employee)

Few accountants expressed a preference for using abbreviated accounts more often than they did; only 7% did so, suggesting few barriers to use exist. Low cost and ease of accessibility meant accountants were able to access Companies House accounts as they wished.

Summing up, accountants in practice were frequent users of abbreviated accounts, either on behalf of clients or for the requirements of their own practice. As with small company respondents and accountants in larger and medium-sized organisations, they felt abbreviated accounts were only useful up to a point – their restricted content meant they were of limited value to users.

Finance and credit management professionals

Banks, credit reference agencies, credit insurers and brokers make decisions to supply finance, credit ratings and insurance cover based on assessments of credit default risk. Finance and credit management professionals routinely use a wide range of financial information sources, including abbreviated accounts, to perform their roles as providers of finance, credit ratings and credit insurance. Each type of organisation operates, and closely guards, their own credit risk models to assess companies’ creditworthiness. Banks use information from accounts to make lending decisions, to monitor those decisions, and to identify companies for marketing purposes. Credit reference agencies often take the entire Companies House register, updated daily, in order to develop and deliver services to clients. Financial information is essential to providing a valuable and, therefore, commercially lucrative, service to

clients. Insurers rely on information from credit reference agencies to make policy cover decisions. Financiers often depend on adequate insurance being in place before making credit decisions.

They're absolutely vital. Without financial information, we'd struggle to treat businesses fairly. We'd certainly struggle to provide credit ratings and credit limits, which our clients rely on... If abbreviated accounts were unavailable, I think there would be a serious deterioration in what we provide to our clients... It would inhibit risk-taking. It certainly wouldn't oil the wheels of commerce. It would have the reverse effect. (Accounts user/intermediary 8: credit reference agency)

In the main, for a lot of companies on our database, the information filed at Companies House is very important to our scoring models, especially for companies where we don't have a lot of other information sources, say, newly-set up companies, companies where we don't have a lot of trade experience data already. (Accounts user/intermediary 9: credit reference agency)

The reason why abbreviated balance sheets are still useful is that you can still work out some pretty good solvency ratios, for instance, total debt to equity, because you've got the right ingredients in the balance sheet. Even in an abbreviated balance sheet, you've got shareholders' equity. And, even in the notes if it's not transparent on the balance sheet, you can see the debt. (Accounts user/intermediary 10: credit reference agency)

Finance and credit management professionals recognise that abbreviated accounts offer a limited insight into a company's financial position and performance. Alternative information sources are often required to provide a well-informed financing, credit rating or insurance decision, although credit-scoring models make allowances for missing financial data. Other things being equal, companies with known turnover and profit data would likely obtain a superior credit rating than other companies, unless the figures reveal poor performance. Some

respondents felt the recent financial crisis and recession had increased demand for real-time information with a concomitant reduction in the value of historical data such as accounts filed at Companies House. This underlies the ambivalence in finance and credit management professionals' perceptions of the value of abbreviated accounts. Companies House provides a starting point for information search – but a limited one.

When you have the full information, you know what the company's turnover is. You know what the company's profitability is. You have some degree of breakdown of the items on the balance sheet. When you have the abbreviated accounts, it's still far better than not having the abbreviated information, obviously, but it's much more about having to make assumptions and make the best use of the available data. (Accounts user/intermediary 9: credit reference agency)

The problem with abbreviated accounts is that a lot of the information that we need to be able to calculate those [financial] ratios is just not available. So we're having to use a very much more limited model which is not nearly as accurate. Which means that... we have to be far more cautious in the level of cover that we are able to [provide]. I think where we do have abbreviated accounts, we would probably tend to reject a higher proportion of those buyers because of that. (Accounts user/intermediary 14: credit insurer)

Summarising, accounts users perceive abbreviated accounts as important data sources to conduct credit risk assessments and take credit decisions. They provide useful information on company balance sheets and equity, that also allow estimates of the value of items excluded from the accounts; key indicator trends can also be tracked over time. Used as a low cost and easily accessible filtering mechanism, abbreviated accounts are of value to users as an aid to deciding whether to increase, or discontinue, information search activity in relation to particular companies. Used in combination with other sources, they provide part of the information 'jigsaw' that supports decision-making

by suppliers, customers, accountants in practice and finance and credit management professionals. But abbreviated accounts are only valuable up to a point: *some* information is better than none, but most users were also very critical of their limitations. Next, we examine user criticisms of abbreviated accounts.

6. Limitations of abbreviated accounts

One high street bank respondent described users of abbreviated accounts as ‘users under sufferance’, who use them only because they are accessible and cheap, rather than because they are entirely fit for purpose. All abbreviated accounts user groups approached – small companies; large and medium-sized organisations; accountants in practice; and finance and credit management professionals – were critical of abbreviated accounts. First, published accounts – both abbreviated and full – suffer from being out of date at the point of use. The Companies Act 2006 permits companies to file accounts at Companies House up to nine months after the financial year-end, which reduces the timeliness of the information. As recent surveys indicate (CBI/ACCA 2010), financiers, credit reference agencies and credit insurers prefer up-to-date management accounts or customer payment behaviour data. The 2008-9 crisis has intensified demand for more timely financial data.

I think things have moved on. So, even if they now filed full accounts – with cash flow, P&L, balance sheet and notes to the accounts – as far as our market-place is concerned, it’s not good enough any more. Abbreviated accounts provided a snapshot of a particular scenario. Full accounts provide a bit more detail but a year to 18 months out of date. That’s no use to anybody in this industry any more. What’s important is real-time financial information that talks about what’s going on currently – as opposed to what happened a year ago. (Accounts user/intermediary 16: trade credit insurance broker)

Second, users consider abbreviated accounts of limited value because they lack detail and offer limited financial transparency. Allied to this, there is some concern that filed accounts might not be accurate as Companies House does not verify the quality of accounts filed. The following remarks could be multiplied many times over from all abbreviated accounts user groups.

To be honest, my view on abbreviated accounts is that they are better than nothing, but not much better. It tells us what their balance sheet looks like, but there's no profit and loss account. You know, there is a big difference between the company that makes a million pound profit and pays a million pounds of dividend, and one that doesn't make any money. And their abbreviated accounts would look exactly the same! (Organisational accountant 3: logistics, 1800 employees)

We'd want to see a greater level of detail on the profit and loss account and the breakdown of creditors to do any meaningful financial analysis to make any credit decision. The information that we get through our own performance scoring systems are considerably more robust than could be gained from an analysis of abbreviated accounts. So we put little emphasis on them. (Accounts user/intermediary 15: high street bank)

For many users, abbreviated accounts alone do not provide an adequate basis for making important business decisions; they require supplementation from other sources. Banks, credit reference agencies and insurers make adjustments for missing information when making credit, credit scoring or insurance cover decisions. Accountants prefer more detailed information in order to make robust assessments of a company's financial position and performance:

You might just say on the theme of abbreviated accounts whether you should bring in a few more disclosure requirements. If we're going to make them worthwhile, why not have more disclosure requirements concerning the balance sheet?... That would make them much more useful for us to look at them. To see what was in the debtors and creditors would be handy. (Accountant 7: 55 employees)

Greater financial transparency facilitates better decision-making. During 2008-9, many insurers reportedly experienced a large volume of small-value claims, linked to the activities of small companies. Credit risk assessments were reported to have tightened considerably as a

consequence of the financial crisis. Insurers appear more sensitive to their exposure to small companies and, consequently, require more information before offering cover to clients trading with them.

Many of the leading insurers made significant losses through 2008-9. The majority of that was small claims on SME companies. That's an area where they need to improve... Unless insurers have proper information on SME companies there's going to be a limit to how much they can support those companies. Certainly, in certain difficult sectors, there's going to be very little leeway given to providing credit unless full information is disclosed. (Accounts user/intermediary 14: credit insurer)

Some suggested that abbreviated accounts were only of value to those unable to access more detailed, or timely, sources of information. Small companies themselves were identified as likely users of abbreviated accounts because they lack the economic power to insist that current and prospective customers, suppliers and others provide more detailed information.

The only users are the ones who aren't powerful enough to get anything else. And they are going to be the small ones. ...so if you're a small company seeking to sell to another small company, to use a bit of credit, you may not be in a position to insist on a full set of accounts. (Accounts user/intermediary 4: finance sector trade association)

Limited information encouraged finance and credit management professionals to err on the side of caution, with adverse consequences for small companies – as seekers/beneficiaries of finance, credit ratings, and credit insurance. Credit insurers have responded to the financial crisis by withdrawing cover due to limited financial information on clients' trading partners, many of whom are small companies. Withdrawal of cover might restrict the level of business small companies are able to win, particularly for new companies with limited assets or trading history.

My contention is that small businesses, by following what they're legally obliged to file at Companies House, it leads to credit starvation, particularly trade credit starvation in the market place. And that's been exacerbated in the credit crisis. (Accounts user/intermediary 10: credit reference agency)

Third, scaled up to the macro, national level, credit constraints were argued to be a major barrier to economic growth as fewer transactions are undertaken, thereby restricting GDP. For finance and credit management professionals, greater financial transparency facilitates superior assessments of credit risk that, in turn, enable a more efficient allocation of credit throughout the economy, better supporting economic activity.

This is the view of a lot of people in the credit information industry. We'd like to see companies filing much more than they do. The government's approach in the last ten years has been to minimise the cost, minimise the amount of information that is being filed for very small companies... But what we would like to see is more information, especially both profit and loss, and balance sheet filed. Because that means there's more information, more transparency in the market so that when companies decide to trade with each other, they can get more reliable, accurate information from us. (Accounts user/intermediary 5: credit reference agency)

While finance and credit management professionals recognise small companies might prefer not to disclose financial information for competitive reasons, the benefits arising from greater disclosure were perceived to outweigh the advantages of confidentiality. Some claimed that small companies are not fully aware of the benefits of greater disclosure, or the risks associated with non-disclosure. Many accounts users – though not small companies themselves – felt that non-disclosure had an adverse impact on small companies' attempts to win business or to obtain credit from banks and other providers. The Doing Business Together group, comprising banks, credit reference agencies, insurers, asset-backed lenders and professional bodies, seeks to help small and

medium-sized enterprises to manage their businesses better and to obtain the credit and finance they require. They insist that increased financial transparency will improve credit allocation and support economic development; small company directors might be unaware of the adverse consequences of non-disclosure for their access to credit.

A lot of companies say there's no negative impact. But they may not know they've had their credit limit reduced. They may not know that they could have opened up more credit with a particular supplier had they had that information available to them. (Accounts user/intermediary 9: credit reference agency)

With credit information, they don't know who's making enquiries on them... Small businesses, whether they like it or not, or whether they understand it or not, they are suffering as a result of the lack of information. (Accounts user/intermediary 10: credit reference agency)

To summarise, there is a clear divergence of view between small company preparers and abbreviated accounts users, particularly finance and credit management professionals, regarding the value of abbreviated accounts. Preparers perceive them as providing an important private benefit, confidentiality. Users, conversely, prefer greater transparency, viewing abbreviated accounts ambivalently as offering some benefits, and being better than nothing, but also, because of their limited information content, as a constraint on decision-making. These constraints arguably impact small company preparers, who perhaps fail to win new business or obtain credit, possibly unbeknown to them, and the wider economy, because poor information impedes efficient credit allocation and, as a consequence, economic development.

7. Accounts users' views on alternative filing scenarios

Accounts users were invited to comment on the likely consequences of two alternative filing scenarios: if the option to file abbreviated accounts was removed and small companies were (a) required to file full accounts; or (b) no longer required to file accounts at all. Users strongly argued for the benefits of greater disclosure and against exemption.

Accounts users agreed – small companies apart – that requiring small companies to file full accounts would be beneficial. Greater transparency would, they maintain, improve the business environment, by increasing user confidence in credit risk assessments and the decisions derived from them. Banks would be more willing to extend loans, overdrafts and other forms of finance. Credit reference agencies would provide higher credit ratings – unless the information published indicated poor, or declining, performance. Credit insurers would be more likely to provide cover to organisations trading with small companies, thereby facilitating higher levels of activity between small companies and others. Users recognised that greater disclosure might enable competitors to exploit information to small companies' detriment, but most felt it would improve credit allocation throughout the economy, with favourable implications for national economic performance.

Small company preparers might counter that greater disclosure would weaken them if they were left unable to compete effectively and, possibly, forced to cease trading, in large numbers, leading to increased concentration. Several small company interview respondents reported that filing full accounts would impact them adversely, either in the form of lost business to competitors, poorer terms in customer and supplier relationships, increased time and cost in the form of higher accountancy fees, and lost privacy with regard to personal finances. Others, conversely, thought the consequences of greater disclosure would be marginal because other companies would be in the same position and, therefore, equally vulnerable to the actions of stakeholders. Whether, and to what extent, such adverse outcomes would be realised in practice is, of course,

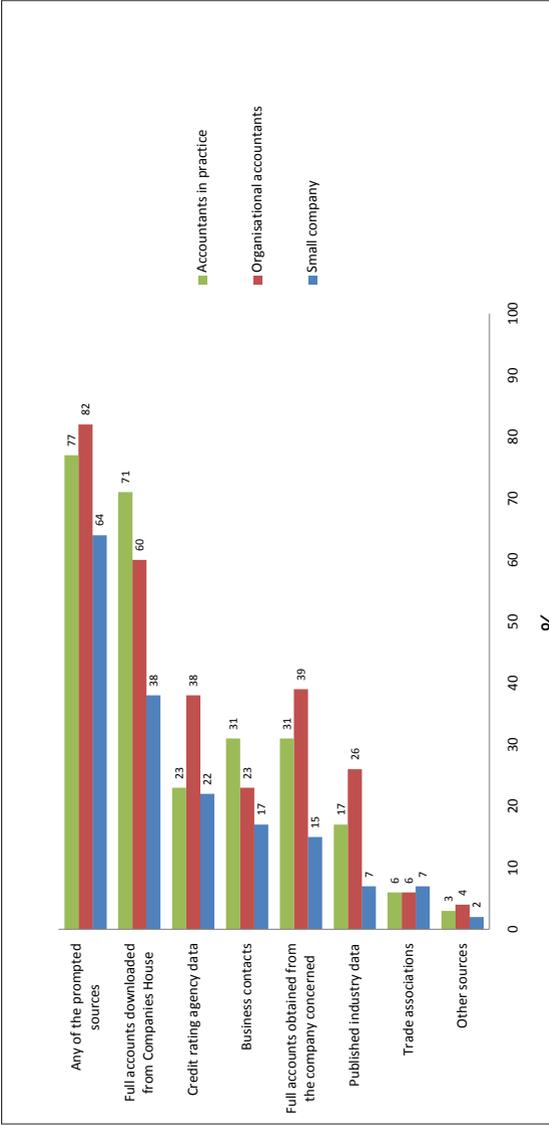
an open question; some companies might suffer badly, others barely at all. Small company interview respondents acknowledged the dilemma involved in their contradictory roles as both preparers and users of abbreviated accounts.

I think that abbreviated accounts is a useful tool because it allows us to comply with the law without giving our competitors too much of a heads up about what we're doing. Whilst it has its disadvantages in terms of me finding out information about other companies, I'm quite happy that people can't find out much about my business. (Company 11: wholesaler, 3 employees)

When I'm looking at suppliers and potential customers and so forth, it's always much more useful to see the trends in their profit and loss accounts, and it's always slightly disappointing when you see... the abridged accounts. It's technically disappointing not to be able to see the profits. But then I do it myself, so I can't really complain. (Company 2: business information service provider, 4 employees)

In the surveys, small companies, organisational accountants, and accountants in practice were each asked what alternative sources of information they would use if small companies were no longer allowed to file abbreviated accounts, and offered a prompt list (Figure 4). Among small companies, almost two-thirds reported one or more of the prompted sources; both accountant groups reported higher figures. Small companies employing an in-house accountant were significantly more likely to use alternative sources of information than companies that did not ($p=0.009$). The rank order of particular information sources was broadly similar across the three groups, with minor variations. For all three groups, full accounts downloaded from Companies House were the most preferred, and trade associations the least preferred, of the prompted sources. Both accountant groups favoured full accounts obtained from the company concerned as the second preferred option whereas small companies preferred credit reference agency data, perhaps reflecting small company difficulties accessing accounts from companies directly.

Figure 4 *Alternative sources of information*



Base: (a) accountants in practice survey (n=255); (b) organisational accountants survey (n=159); (c) small company survey (n=149).

Each group of accounts users were asked to rate the usefulness of each information source on a 5-point scale, from 'very useful' (score 5) through to 'not useful at all' (score 1).¹⁰ Each group ranked statutory full accounts as the best source of information – small companies (mean rating 4.1), organisational accountants (4.1) and accountants in practice (4.4). Business contacts were ranked second in each of the three groups. All other prompted sources, with the exception of credit reference agency data for both accountant groups, were considered less useful with mean ratings of 3.0 or lower.

Accounts users identified a number of disadvantages of small company exemption from filing any statutory accounts; none cited any benefits. In addition to aggravating the problem of limited transparency, users believed exemption might encourage financial indiscipline. Lacking any obligation to make information publicly accessible, small company directors might be encouraged to adopt unsound financial management practices. Such behaviour would lead to problems for small companies and undermine stakeholder confidence by increasing the risks of transacting business with them. Customers and suppliers, for example, might shift their attention to larger organisations, whose information is available, as trust in small companies decline.

If abbreviated accounts were unavailable, I think there would be a serious deterioration in what we provide to our clients... It would inhibit risk-taking. It certainly wouldn't oil the wheels of commerce. It would have the reverse effect. (Accounts user/intermediary 8: credit reference agency)

Accounts users perceived reductions in small company filing requirements as highly likely to aggravate problems of credit risk assessment and increase the likelihood of small company failure to win business and obtain adequate credit from suppliers, banks and other financiers. For users, requiring small companies to disclose more information, for example, by filing full accounts, would be beneficial; abolishing the requirement to register accounts at all would, they believe, only produce difficulties. As both preparers and users of abbreviated accounts, small company respondents were often ambivalent, although most were keen to retain the option to file them.

8. Conclusions and policy implications

This study has contributed to the limited literature and policy debate on the value of abbreviated accounts to small company preparers and accounts users – small companies; large and medium-sized organisations in the private, public and voluntary sectors; accountants in practice; and finance and credit management professionals. For preparers, the option to file abbreviated accounts is perceived to provide confidentiality, valued for both business and personal reasons. For users, abbreviated accounts are valued as a filtering mechanism, or as part of the information ‘jigsaw’, enabling decisions to extend, or discontinue, information search activity. Both preparers and users recognise the important function played by Companies House as a source of low cost, easily accessible information.

A key theme to emerge from the study is the tension between the interests of small company preparers and abbreviated accounts users. Preparers seek financial confidentiality; users prefer transparency. This tension is most evident among the large minority of small companies who are also accounts users. The paradox for small companies is that both confidentiality *and* transparency potentially serve their interests. Confidentiality protects small companies from users whose actions might harm them. At the same time, it limits the support that others – financiers, suppliers, credit reference agencies and insurers – might provide. Permitting small companies to file abbreviated accounts might, therefore, generate unintended, damaging consequences, although these might possibly be unknown to small companies themselves. Transparency potentially overcomes such consequences while at the same time making it easier for competitors and others to exploit financial information in a manner that might threaten small company performance. In the aftermath of the financial crisis, and the part played by poor credit risk assessment, the limitations of abbreviated accounts have become increasingly evident. There are signs that accounts users are demanding more detailed and timely information as a condition for supplying credit, credit ratings and insurance cover. Whether such a

response is a temporary adjustment to the financial crisis and will loosen as economic circumstances improve remains an open question.

Accountants in practice play a key role in small company decisions to file abbreviated accounts and in client decisions to use abbreviated accounts. For many accountants, filing abbreviated accounts on behalf of small company clients is the 'default' option, only to be departed from in specific circumstances. Their role as users on behalf of clients, many of whom are small companies, appears to be more important than using them for the requirements of their own practices.

For policy makers, there is a trade-off between reducing the regulatory burden on small companies in order to try to stimulate growth and increasing the transparency of financial information in order to reduce business uncertainty, improve credit allocation, and facilitate economic development. Recent European Commission proposals, and supportive UK government statements, to exempt micro-entities from financial reporting obligations suggest that deregulation is favoured. But, reducing financial reporting obligations might produce unintended adverse outcomes. While potentially freeing up time for directors to focus on business development, deregulation might also aggravate the adverse consequences that flow from declining financial transparency. Some companies might adapt to a more relaxed reporting regime, possibly following accountants' advice, by not filing accounts at all. For accounts users, this would be a retrograde step. In a highly risk-sensitive environment, businesses, financiers, credit reference agencies and insurers might be unwilling to trade, extend credit, provide satisfactory ratings and offer adequate insurance cover to small companies and those who trade with them.

It might be argued that many micro-companies do not benefit from financial disclosure. Many do not aim to grow or seek external finance, and trade mainly with businesses whose decisions are not influenced by credit reference agencies or insurers. Such companies would not, therefore, suffer unduly from lower levels of transparency. For these companies, reducing reporting obligations might potentially offer some benefits in terms of greater confidentiality and from time and cost savings arising from not filing accounts at Companies House. These gains seem likely to be marginal in relation to those associated with current levels

of public disclosure. Such companies, moreover, are unlikely to be the growth engines of tomorrow that the government is seeking to support. Potential customers and suppliers might be willing, for example, to do business with particular micro-companies but choose not to because they perceive the company as a credit risk on the basis of them not filing accounts. Yet company directors might remain unaware of this, even where they would be willing, if approached directly, to disclose detailed accounts information. Moreover, stakeholders might perceive the absence of filed accounts as indicative of a wider problem of poor management, rather than simply a means of retaining confidentiality. One might propose, therefore, to retain the present position with regard to small companies' reporting requirements. This will avoid imposing additional regulatory burdens on businesses in difficult times, while at the same time resisting the temptation to abolish micro-entities' current obligations.

Endnotes

- 1 The Fourth Company Law Directive refers to ‘abridged’ accounts. The UK’s Company Act 1981 refers to ‘modified’ accounts, later changed to ‘abbreviated’ accounts in the Companies Act 1989 and retained in the Companies Act 2006.
- 2 Entities qualifying as medium-sized are also permitted to file abbreviated accounts, but greater disclosure is required than for small companies.
- 3 FAME holds financial information and contact details for 2.8 million active companies in the UK and Ireland. The financial data for UK companies is taken from annual returns made to Companies House.
- 4 These thresholds reflect the European Commission’s initial proposed ceilings for the new category of micro-entities, introduced on p14. The small number of sample companies above the thresholds means that inferences from the data should be drawn with caution.
- 5 Chi-square tests were conducted on survey data to explore whether variables were associated. Variables have been constructed with two response categories to facilitate the tests. Only relationships with p values lower than 0.1 are reported as significant. Pearson chi-square statistics are shown in brackets for each significant association identified; these indicate the likelihood of such an association being due to chance. Cases with missing data are excluded from the tests.
- 6 This estimate has been derived as follows. During April-November 2010, there were 1.001m accounts downloads; this annualises to 1.5015 millions. An estimated 62.3% of accounts filed during April-December 2010 were small company abbreviated accounts. Multiplying 1.5015m by 0.623 equals 934,435. This figure may be subject to some degree of error due to possible variation in accounts classification within Companies House procedures (email communication).

- 7 Each of these correlations should be interpreted with caution as one cell in the correlation matrix has an expected count of less than five.
- 8 Data is missing in 7% of cases.
- 9 Nine per cent of the sample provided no data on extent of use.
- 10 Numbers rating information sources varied across the three samples. For small companies, numbers varied from 35 (trade associations) to 64 (business contacts); for organisational accountants, from 62 (trade associations) to 124 (statutory full accounts); and for accountants in practice, from 90 (trade associations) to 211 (statutory full accounts).

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About SATER

The research projects which culminated in this publication were funded by grants from The Scottish Accountancy Trust for Education & Research (SATER) – a registered Scottish Charity (SC034836). The SATER Trustees are pleased to have been able to support these projects and hope that the results are of interest and relevance to a broad range of users.

SATER's objective is to promote research into, and education of, accountancy, finance and management together with all subjects in any way related. In fulfilling its charitable objectives, it also seeks to provide public benefit by making grants for research projects which result in reliable evidence for use in the development of policy – by professional bodies, standard setters, regulators or governments.

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Further details about SATER and the ICAS research programme can be found from the SATER and ICAS websites: scottishaccountancytrust.org.uk/research.html and icas.org.uk/research.

David Spence
Chairman of SATER

June 2011

While financial reporting research focuses predominantly on large and listed companies, we should not lose sight of the vast number of small companies. Limited liability status places an obligation on companies to file their accounts on the public record, although for small companies there is an option to file abbreviated rather than full accounts. But what impact does this option have on users and preparers and what is the impact on the wider economy? Are abbreviated accounts fit for purpose?

This study explores the views of preparers and users of small company abbreviated accounts using survey and interview data to investigate opinion on the value of small company abbreviated accounts. A key theme to emerge from the study is the tension between the interests of small company preparers and the users of abbreviated accounts.

For policy-makers, there is a trade-off between reducing the regulatory burden on small companies and improving the transparency of financial information. Recent European Commission and UK government proposals suggest that further deregulation may be favoured in this area. It is hoped that this report will be useful to the ongoing UK government and EC deliberations on this important issue.

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