THE BURDEN OF ACCOUNTING STANDARDS FOR SMALL AND MEDIUM ENTERPRISES. A SUGGESTIVE SOLUTION

Marco Sorrentino*, Margherita Smarra*

Abstract

Anglo-Saxon accounting literature has traditionally connected the U.S. stock market crisis of the late 1960s and the consequent proliferation of complex and detailed accounting standards with the origin of a complex problem, commonly known as *"accounting standards overload"*, that can be defined along two different but correlated perspectives:

1. the question of comparing costs and benefits of complying with accounting standards by small and/or privately held entities;
2. the competitive disadvantage for public accountants (CPAs) who serve these entities.

This paper begins with a background and purposes of the study (par. 1) followed by the analysis of the main literature of the general phenomenon of accounting standard overload (par. 2). Paragraph 3 focalizes on the cost-benefit analysis of complying with accounting standards by small and medium entities and then paragraph 4 describes the solutions adopted in the main Anglo-Saxon countries (par. 4.1), with a particular reference to the "Non-reporting entity" concept (par. 4.2). Finally, the authors share their personal observations (par. 5).

Keywords: Accounting Standards Overload, Compliance Costs, Differential Reporting, Reporting Entity, SME

* *Lecturer in Accounting, Department of Legal Sciences and Economics – Pegaso Telematic University, Piazza Trieste e Trento, 48 – 80132 – Naples – Italy*
Tel. +39 081 195 60 363 – Fax. +39 081 195 60 354
Email: marco.sorrentino@unipegaso.it
*** PhD student, Department of Economics, Management and Institutions – University of Naples, Via Cinthia, 21 – 80100 – Naples – Italy*
Email: margherita.smarra@unina.it

1. Background and purposes of this study

Beginning in the late 1960s and continuing into the mid-1970s, there was a sharp and unexpected decline in the U.S. stock market, as demonstrated in the following figure that shows the performance of Dow Jones index from 1969 to 1975.

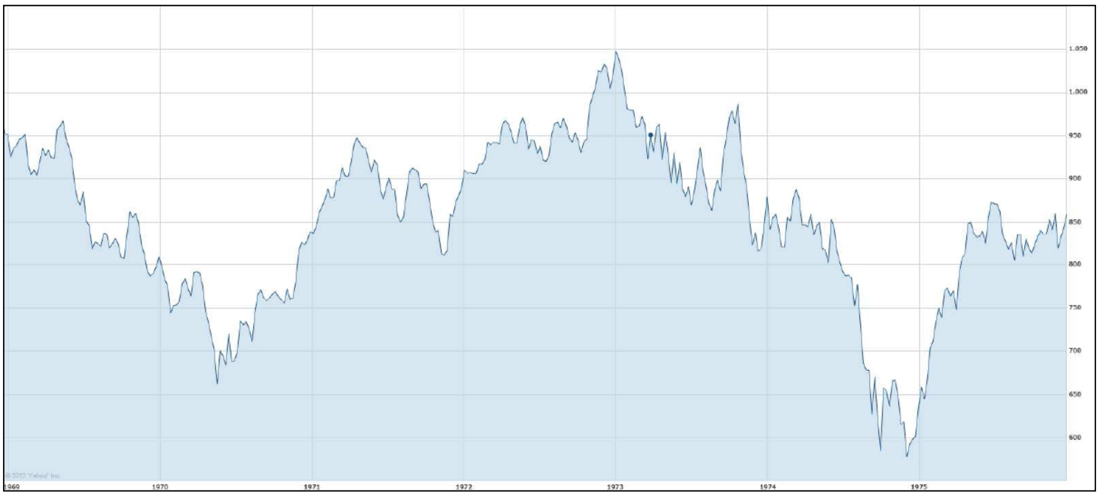

Figure 1. Index performance for Dow Jones from 1969 to 1975
Source: http://it.finance.yahoo.com/

Damaged investors undertook successful litigations against the public accountants (CPAs), who were forced to pay them onerous compensations. These lawsuits brought to the fore questions of whether accounting standards, mainly developed and interpreted by public accountants at that time, fairly reflected the nature of business transactions. As a direct consequence of that, so to reduce their individual judgment, accountants started to issue a greater and greater number of detailed standards. They perceived that the more explicit the standards, the better their legal defence.

At the same time, the U.S. Government established an extensive regulation policy, above all in the accounting context, in an explicit answer to the protection needs of the entire financial community.

These two specific circumstances, associated with some general conditions like the high level of inflation, the high oil prices and the rapid technological changes, had a direct and significant effect on the proliferation of complex and detailed accounting standards (Hepp and McRae, 1982; Hertz, 1983; Thompson, 1983; Sorrentino, 2013).

Anglo-Saxon accounting literature[2] has traditionally connected this period and the generic question of proliferation of accounting standards with the origin of a complex problem, commonly known as *"accounting standards overload"* (from now on, also just *standard overload*).

2. Accounting standards overload: doctrinal definition of a complex phenomenon

An effective general definition of this issue is given by Belkaoui (2004), who identifies standard overload as one or more of the followings conditions:

1. too many standards;
2. too detailed standards;
3. no rigid standards, making selectivity of application difficult;
4. general-purpose standards failing to provide for differences in the needs of preparers, users and CPAs;
5. general-purpose standards failing to provide for differences between:
   a. public and nonpublic entities;
   b. annual and interim financial statements;
   c. large and small enterprises; and
   d. audited and nonaudited financial statements;
6. excessive disclosures, complex measurements or both[3].

Firstly, this classification contributes to explain the high complexity of the analyzed question; at the same time, it defines the main themes that Anglo-Saxon accounting literature, with a different emphasis, has indistinctly identified with the concept of standard overload.

Indeed, McCahey and Ramsay (1989) associate a standard overload phenomenon with the condition of superabundance and complexity of accounting standards, whose implementation for small entities causes an excess of costs in comparison with related benefits. Consequently, the authors claim that accounting standards overload problem could be defined along two different but correlated perspectives:

2) the question of comparing the costs and the benefits of complying with accounting standards by small business entities[4];

3) the impact on the accounting profession.

As to the first perspective, McCahey and Ramsay (1989) highlight two important aspects. They claim that compliance costs with accounting standards are proportionally higher for small business entities than for larger ones; at the same time, they believe that information needs of financial statements' users are dependent on both business proprietary regime and size. Indeed, it is widely accepted that principal users of public company financial statements are financial analysts and public stockholders, while financial statements of smaller and/or closely held businesses are usually directed toward owner-managers and bankers or other credit grantors (DeThomas and Fredenberger, 1985; Chazen and Benson, 1978). Because of most standard setters substantially focus on the information needs of present and potential investors (Scott, 2002), the users of smaller and/or non-public entities financial statements might obtain less benefits through the application of accounting standards.

As to the impact on accounting profession, McCahey and Ramsay (1989) claim that the excessive proliferation of accounting standards causes a condition of competitive disadvantage for small accounting firms. These firms have got limited structures and operate prevalently with small business entities, so they should be subjected to:

- relatively higher education costs than large accounting firms;
- a high pressure from independent accountants that are not deontologically due to respect accounting standards and offer their services more cheaply;
- a hard resistance from small business entities to the inevitable fee increase caused by the growing complexity of accounting standards. Indeed, small business entities do not get great benefits from using accounting standards, so to consider them useless and expensive.

This situation could be an incentive for public accountants to avoid or limit the use of accounting standards for drawing up financial statements of smaller and/or closely held businesses and so reducing the quality of accounting information.

[2] The interpretation of Anglo-Saxon accounting concept is not univocal in literature, as demonstrated by the different opinions of Flower (1997) and Nobes (2003) on one side, and Alexander and Archer (2000), on the other side.

[3] This classification was originally formulated by the *Special Committee on Standards Overload* (AICPA, 1981).

[4] In this paper, *small business entity*, *small entity* and *small private entity* have been used in the same meaning.

Hepp and McRae (1982) support a similar opinion. They maintain that a condition of standard overload raises if the benefits of required information to the users of small business's financial statements do not exceed their costs.

Within this background, the authors believe that the fist step in finding a solution to the problem is to identify the dimensions in which it appears. Also in this case, they identify two principal perspectives:

- the one of small business entities and their financial statements' users;
- the one of the practitioners (public accountants) who serve those entities.

The arguments suggested by Hepp and McRae (1982) in their work focus on similar aspects argued by Ramsay and McCahey (1989). Nevertheless, they highlight a further important element: the *opportunity cost* incurred by small business entities.

The authors believe that small business entities could use time and money spent on developing the detailed but unproductive requirements of accounting standards to produce more useful and effective information for the principal users of their financial statements.

Similarly, Nair and Rittenberg (1983a) address the standard overload phenomenon using the following logical sequence:

- accounting standards and required disclosures have been formulated with large publicly held companies in mind;
- small and privately held businesses may therefore have had to incur costs in excess of the benefits received from complying with these standards; and
- users of financial statements of small and nonpublic companies are generally owner-managers and lenders who are close to the scene and have alternative sources of information available to them.

A somehow different analysis of accounting standard overload issue is given by Thompson (1983). The author, questioning the prevalent doctrinal interpretation, believes the problem of boundless proliferation of complex accounting standards concerns all the entities (small and large; public and nonpublic) with the same intensity. At the same time, he claims that not just the public accountants of small accounting firms, but all the practitioners, as well as the users of accounting data, are oppressed by an excessive and often confused burden of information. So, more than accounting standards overload, this phenomenon might be defined as *accounting standards confusion* (Walther, 1983).

Within this context, it is interesting to examine the logical path followed by Mosso (1983) in his analysis. The author, in a kind of ideal response to the critical considerations of Thompson, illustrates the standard overload issue, using a partially alternative approach. Although focusing on the two main perspectives supported in literature, Mosso (1983, p. 126) restates the question, basing his analysis on the following arguments:

1) regarding small business entities, the author argues that:

- accounting standards are developed primarily for external users of financial statements;
- in relation to the size, small companies have fewer external users of their financial statements than large companies;
- in relation to size, the cost of accounting standards requirements is greater for small companies than for large companies;
- therefore, the cost of accounting standards requirements per unit of benefits and per external users is much higher for small private companies and may exceed the benefits for some requirements.

2) as the impact on accounting profession, Mosso asserts that:

- the expansion of accounting standards imposes a burden on all CPAs to update their professional knowledge;
- small CPA firms cannot reduce the burden on individual CPAs though specialization as easily as large firms do;
- in addition, small CPA firms may face greater fee resistance than large firms;
- therefore, the expansion of accounting standards puts small CPA firms at a competitive disadvantage and threatens to erode the quality of professional practice.

In conclusion, this brief analysis underlines both the substantial coherence in identifying accounting standards overload issue and the relevance this issue has been getting in the last forty years. Indeed, Anglo-Saxon accounting literature defines this complex phenomenon along the two prevalent following perspectives:

1. The cost\benefit relationship of complying with accounting standards by small business entities; and
2. The competitive disadvantage for public accountants (CPAs) who serve these entities.

Moreover, the increasing interest the problem of excessive proliferation of accounting standards has been generating by the time is proved by the following assertion (Hepp and McRae, 1892, p. 53):

"It does not matter whether there is in fact a problem of unnecessary or ill-conceived standards or just a feeling of 'too much'. The mere fact that so many believe there is an accounting standards overload is sufficient evidence that the problem requires attention."

3. Evolution of the problem in the U.S. context: AICPA, FASB and empirical evidence

Since the half of the seventies, both the A.I.C.P.A. (American Institute of Certified Public Accountants) and the F.A.S.B. (Financial Accounting Standards Board) expressed great interest in the accounting standards overload issue.

In August 1976, the first official pronouncement on this topic was issued by the *Committee on Generally Accepted Accounting Principles for Smaller and/or Closely Held Business* (also known as *Werner Committee*) (AICPA, 1976). This committee was created by AICPA to analyze the problems of the application of generally accepted accounting principles (namely, GAAP) to smaller and/or closely held businesses[5].

Based on the responses to a discussion paper issued a year before (AICPA, 1975), the *Werner Committee* (AICPA, 1976) concludes that different size and/or proprietary regime should not cause the application of different measurement criteria, because the measurement process should be independent of the nature of users and their interest in the resulting measurements. Conversely, the nature and the detail of the information disclosed is strictly dependent on the needs of the users and should be opportunely differentiated. So, the Committee believes that FASB should guarantee a set of accounting principles to be indistinctly applied in general-purpose financial statements of all entities. These principles should be characterized by a general level of disclosure (*core disclosure*), integrated with specific requirements in order to provide additional and analytical data (*supplemetary disclosure*).

In other words, measurement criteria should be the same for all the entities, while there should be a differentiation in the information disclosed.

In spite of its common acceptance and its practical use, this solution has been partly criticized in consideration of the main doctrinal opinions of accounting standards overload phenomenon:

- first of all, a mere disclosure differentiation could be of little or no avail in the question of cost\benefit relationship for small business entities. In fact, compliance costs are mainly dependent on the measurement process (McCahey and Ramsay, 1989);
- secondly, the outcome of this solution is inevitably due to the effective but highly arbitrary distinction between the information required to all entities (*core disclosure*) and the information required just in particular circumstances (*supplementary disclosure*) (Upton and Ostergaard, 1986);
- at last, this kind of differentiation might not alleviate the competitive disadvantage for part of the accounting profession (McCahey and Ramsay, 1989).

Accordingly, just four years later, the *Special Committee on Small and Medium-Sized Firms* (also known as *Derieux Committee*) concludes that simple exemption for certain entities from supplementary disclosure could be ineffective to mitigate the disadvantages suffered by smaller entities. So, the *Derieux Committee* suggests AICPA to establish another committee to analyze this potential problem (AICPA, 1980).

In the Spring of 1981, the setup of the *Special Committee on Standards Overload* (better known as *Scott Committee*) gave definitively official acknowledge to the issue of accounting standards overload. Indeed, the declared scope of this committee is (AICPA, 1981, p. 3): "(…) to consider alternative means of dealing with accounting standards overload, with emphasis on small, closely held businesses."

Scott Committee's conclusions are somehow innovative. It introduces the possibility to differentiate accounting information not just basing on different disclosure, but also on different measurement criteria (Kelley, 1982).

In fact, its final report (AICPA, 1983) recommends FASB:

- to reconsider promptly some accounting standards widely perceived as unnecessarily burdensome and costly;
- to simplify existing standards when possible and make simplicity a goal in future standards (Hepp G.P., McRae T.W., 1982; Thompson J.A., 1983; Nair R.D. Rittenberg L., 1983; Beresford D.R., 1999; Effes E.M., 2004; Nobes C., 2005);
- to consider a simplified accounting standards set for all businesses and differential disclosure and measurements alternatives for smaller and/or closely held entities (Richardson and Wright, 1986);
- to continue its research on the needs of users of financial statements of smaller and/or closely held entities.

On its side, the FASB, stimulated by the frequent solicitations from AICPA and in consideration of the more and more intense concern of the entire financial community, put standard overload question on its agenda. On this topic, it is remarkable to highlight two relevant empirical surveys:

- FASB, (1983) *Financial Reporting by Privately Owned Companies: Summary of Responses to FASB Invitation to Comment*. (Stamford: Financial Accounting Standards Board);
- Abdel-khalik A.R., (1983) *Financial Reporting by Private Companies: Analysis and Diagnosis*. (Stamford: Financial Accounting Standards Board).

Both these studies analyse the question of comparing the costs and the benefits of complying with accounting standards by private and/or small companies and the potential different information needs of their users. So, the studies focus on three principal groups involved with financial reporting by private companies: management of those companies (managers), lending officers of commercial banks

[5] However, in 1952 a report by a group of lawyers, accountants and businessmen handed by George O. May stated that (Mann, 1982, p. 31): "there is no public interest which calls for applying to the hundreds of thousands of small corporations, whose management and ownership are closely combined, requirements deemed appropriate for the guidance of investors in the few thousand large corporations whose securities are widely distributed (…) The service which accounting renders to this type of enterprise, though importance, is of a character different form that rendered to the large company whose ownership is widely distributed.".

(bankers) and their accountants (public accountants or practitioners).

However, the results of these studies show that standard overload phenomenon is almost exclusively perceived by public accountants. Managers and above all users assess positively the benefits associated with the application of accounting standards, even if they are aware of their compliance costs. In fact, summarizing the results of these surveys, Mosso (1983, p. 124) concludes that: "(…) responses to research questions lend little or no support for CPAs' expressed concern about lack of relevance and only modest support for their expressed concern about overall cost-benefit deficiencies."[6].

In the following years, the FASB commissioned several studies about small business financial reporting, but the answers suggested by these studies have often conflicted (FASB, 1986; Upton and Ostergaard, 1986). As a consequence, FASB policy was and still is just to allow certain entities to provide different disclosure details (but not different measurement criteria). This disclosure differentiation is not based on a specific criterion (for example, small/large entities or listed/non-listed entities), but on a specific cost/benefit analysis regarding the application of every single accounting standard (FASB, 2004).

Other than the ones explicitly required by institutional and professional organizations, several empirical researches related to standard overload issue were independently carried out by the Anglo-Saxon accounting literature.

In their surveys, Nair and Rittenberg (1983a; 1983b) try to investigate the views of financial statement users, as well as those of CPAs and members of business community, on accounting standards overload issue. Confirming the results showed by Abdel-khalik's research, bankers[7] perceive no difference in their needs regarding the financial statements of large entities and the financial statements of small and privately held businesses[8]. Differently, the managers and the CPAs perceive a difference and agree that compliance with accounting standards is costly. However, managers do not associate the increases in total accounting costs principally with the increase in the complexity of accounting regulation. So, also in this case, empirical evidence reveals that accounting standards overload problem is mainly perceived by accounting profession.

Knutson and Wichmann (1984; 1985) implicitly confirm this last assertion. The authors believe the accountants have an unique position as the link between the reporting entity and the users of their accounting information. So, they are, more than any other party, in a key-position to define the relevance of accounting information for many different types of users. Consequently, their researches are addressed to practicing accounting professionals (CPAs). It is also interesting to underline that their studies, questioning most of the other analyzed works, investigate both the size aspect (small/large entities) and the public accountability one (privately/publicly-owned entities).

Knutson and Wichmann (1984; 1985) identify an accounting standards overload context, concluding that:

- public accountants reject the assumption that most disclosure are equally important for sizes and types of entities;
- disclosure requirements are considered more important for publicly-owned entities than for privately-owned ones;
- disclosure requirements are considered more important for large privately-owned entities than for smaller privately-owned ones; and
- on the contrary, disclosure requirements are not considered significantly more important for large publicly-owned entities than for smaller publicly-owned ones.

Friedlob and Plewa (1984; 1992) formulated remarkable conclusions on this topic, even if without empirical support. The authors, in contrast with Knutson and Wichmann's conclusions, argue that standard overload problem should be analyzed mainly considering costs and benefits of small private companies' owners. According to them, the owners are the only subjects that bear accounting costs and so they are the only subjects able to provide objective and suitable considerations about this question. Conversely, the users are free-riders and so they are inclined to assess positively more numerous and detailed accounting information; while, public accountants, being "deontologically" due to apply accounting standards requirements, tend to essentially underline their negative aspects.

Atiase, Bamber and Freeman (1988) analyze a few empirical studies concerning publicly held companies. On one side, the authors evidence that the professional literature has argued that certain disclosure may be relatively more costly for small companies than for larger ones; on the other side, they surprisingly notice that investors are more dependent on small companies' disclosures than on those of larger companies. They conclude that, considering differential reporting requirements, FASB and SEC should ponder different value of large versus small companies' disclosures against differential compliance costs incurred by the companies.

[6] The author goes on: "Those who are most concerned with the information relevance – external users of financial statements – strongly disagree with the CPA view. Those who bear the direct cost and get the principal benefit of financial statements – managers of small companies – are a bit ambivalent but by and large not nearly as agitated as CPAs seem to think. So I am led to think that there must be other roots to the standards overload problem as CPAs see it.", (Mosso, 1983, p. 124).

[7] In their surveys, Nair and Rittenberg point out bankers are the primary users of privately held companies financial statements, both for the manages and the CPAs.

[8] Similar conclusions have been formulated by Stanga and Tiller, (1983).

At the end of this review, it is also interesting to highlight the results of a survey carried out by the *Private Company Financial Reporting Task Force* (AICPA, 2005). In the early 2004, this *Task Force* was appointed by the AICPA Board[9] to conduct comprehensive research to explore whether:

- the general purpose of financial statements of private companies, prepared in accordance with GAAP, meet the financial reporting needs of constituents of that reporting;
- the cost of providing GAAP financial statements is justified compared with the benefits they provide to private company constituents.

Basing on the constituents' responses, the *Task Force* concludes that:

- GAAP currently is not adequately meeting the distinctly different needs of private company constituents. Therefore, GAAP for private companies should be developed based on concepts and accounting that are appropriate for the distinctly different needs of constituents of that financial reporting;
- fundamental changes should be made in the current GAAP standards-setting process to ensure that the financial reporting needs of private company constituents are met.
- any private company financial reporting solution must be a widely-embraced, recognized set of standards that are generally accepted accounting principles.

By the careful analysis of this last study, associated with the different conclusions of the single Committees, it is interesting to underline the logical evolution of the AICPA policy that has substantially argued the necessity of a differentiation for small and/or privately held companies both in terms of measurement criteria and information to disclose. However, the contrasting results of the several empirical researches on this topic allow to claim that standards overload phenomenon, originally perceived more than forty years ago, is still so far to be unequivocally interpreted by the entire financial community[10].

4. The standard overload problem and the different enforcement models of accounting rules in Anglo-Saxon Accounting

4.1 The different enforcement models of accounting standards in U.S., in United Kingdom and in Australia

The different models of enforcing accounting standards are undoubtedly another relevant aspect to take into consideration for analyzing standard overload phenomenon. According to McCahey and Ramsay (1989), the perception of this phenomenon might be different depending on the jurisdiction that one is in.

In the United States 0,03% of about 5 million corporations are registered with the SEC (*Securities and Exchange Commission*) and so they are the only entities legally due to comply with accounting standards issued by FASB in drawing up their financial statements. In fact, the SEC considers the compliance with the S.F.A.S. (*Statements of Financial Accounting Standards*) a necessary condition to operate in capital markets.

Differently, in the United Kingdom all the limited liability companies[11] (that are not under the International Accounting Standards Regulation – EU Regulation 1606/2002) are "substantially" obligated to use UK national accounting standards (namely, the standards issued by the Accounting Standards Board – ASB). Indeed, the Companies Act 1985 requires accounts to give a "true and fair view" and UK national accounting standards derive their legal authority from this requirement as they represent authoritative statements of how transactions and other events should be reflected in financial statements Taylor and Turley (1986). The "implicit" strength of UK national accounting standards is clearly showed by the following declaration of *Financial Reporting Review Panel* (FRRP):

"Companies that continue to prepare accounts in accordance with UK national standards remain subject to the overriding requirement of the Act [*The Companies Act 1985*] that accounts give a true and fair view, which, in all but highly exceptional cases, requires compliance with UK accounting standards"[12]

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[9] During the nineties, the *American Institute of Certified Public Accountants* issued other two documents on accounting standards overload question: American Institute of Certified Public Accountants (AICPA) (1995) *Standards Overload: Problems and Solutions*. (New York: AICPA); American Institute of Certified Public Accountants (AICPA) (1996) *Report of the Private Companies Practice Section Special Task Force on Standards Overload*. (New York: AICPA).

[10] This consideration is even more proved by the further contrasting results got by other empirical researches. For example, Carsberg et al. (1985, p. 91) say: "We do not believe that a case exists for exemptions from all accounting standards of all companies below a certain size or of all private companies. Nor do we think that a separate code of generally accepted accounting principles for such companies should be considered (…)"; conversely, McCahey and Ramsay (1989, p. 20) declare: "Sources of evidence that supports the contention that the problem of accounting standards overload exists in Australia include the following (…)".

It is possible to find contrasting empirical results also in: Page, (1984); Keasey and Short, (1990); Collis, Dugdale and Jarvis, (2001); Barker and Noonan, (1996); Ramsey and Sutcliffe, (1986); Ramsey, (1989); Pini M., D'Amico L., Paoloni M., Marasca S., Paolini A., (1996); Paoloni M., Demartini P. (1997a); Paoloni M., Demartini P. (1997b); Paoloni M., Demartini P. (1998); Moneva J.M., Cuellar B., Paoloni M., Demartini P., (2001); Paoloni P., (2004); Cesaroni F.M., Paoloni P., (2006); Baldarelli M.G., Demartini P., Mosnja-Skare L., (2007); Sorrentino M., (2012).

[11] Since 1994, some small entities were exempted from obligatorily auditing their accounts.

[12] FRRP website: http://www.asb.org.uk/frrp/press/pub0826.html.

Finally, in Australia accounting standards are legally imposed by the Government. By the section 296 of Corporation Act 2001, all the companies[13] are required to comply with accounting standards issued by Australian Accounting Standards Board (AASB) for preparing their financial statements. Moreover, since in 2002 Australian Government required these entities to comply with accounting standards issued by IASB, nowadays the Australia national accounting standards substantially coincide with IAS/IFRSs.

In comparison with these different ways of enforcing accounting standards, it is possible to observe alternative approaches in dealing with standard overload issue.

The FASB allows specific categories of reporting entities to apply a differential disclosure (but not different measurement criteria). These specific categories of reporting entities are time by time identified through a cost/benefit analysis regarding the application of every single accounting standard.

The UK standard setter used a surely more organic approach. In November 1997, after a ten-year process, the Accounting Standards Committee (ASC – now ASB) issued a specific and complete document, the *Financial Reporting Standard for Smaller Entities* (FRSSE)[14]. This document prescribes the basis, for those entities within its scope (the *smaller entities*) that have chosen to adopt it, for preparing and presenting their financial statements. In order to qualify these entities, the Accounting Standards Board refers to the "classical" size criteria used by the Company Act 1985 in legally defining a small company[15]. Reporting entities that apply FRSSE are exempt from complying with other accounting standards issued by ASB in order to give a "true and fair view" of their accounts.

Even if apparently innovative, this approach has been interpreted as an illusory solution more than a concrete response to standard overload question. In a user-oriented context, as the Anglo-Saxon one, the needs of financial statements' users should determine the objectives of financial reporting and so their needs should govern the form and the content of financial statements. Accordingly, the FRSSE should have been realized considering the main information needs of users of smaller businesses' financial statements (Jarvis, 1996). Conversely, this document is prevalently considered a pragmatic relaxation of disclosure rules rather than any new form of financial reporting tailored to the needs of small businesses (Dames, Paterson, and Wilson, 1999). Indeed, the definition of the entities that are allowed to apply the FRSSE is based on the arbitrary size criteria rather than on substantial criteria like the compositions of its membership and management.

The Australian accounting context is characterized by another significantly different approach. A more concrete response to accounting standards overload problem is given by a two-level system of differential reporting:

- a first *formal* level, that identifies the entities obligated to comply with accounting standards through the classical criteria of *legal structure* and *business size*;
- a second *substantial* level, that delimits the application of the formal one and identifies the entities that are "concretely" obligated to comply with accounting standards (also defined *reporting entities*) considering the existence of information needs to satisfy.

On this subject, the *Statement of Accounting Concept n. 1* (S.A.C. 1) states that the aim of a General Purpose Financial Report (GPFR) is to meet the information needs common to users who are unable to command the preparation of reports tailored so as to satisfy, specifically, all of their information needs (AASB, 1990).

Furthermore, a GPFR, whose preparation implies the compliance with Statements of Accounting Concepts and Accounting Standards issued by AASB, has to be drown up by all entities in respect of which it is reasonable to expect the existence of users dependent on general purpose financial reports for information which will be useful to them for making and evaluating decisions about the allocation of scarce resources. These entities are just defined *reporting entities*.

In other words, the law imposes all the companies (listed and non-listed) to comply with accounting standards in drawing up their financial statements (*formal* level of differential reporting). At the same time, accounting standards, basing on *reporting entity* concept, condition their obligatory and integral application to the existence of users really interested in information that derive from them (*substantial* level of differential reporting). Yet, "substantial" recognition of IAS/IFRSs as new accounting rules to apply in the Australian context has not apparently damaged the functioning of this sequential system of differential reporting[16].

So, in a coherent view with an user-oriented approach, there is a link between the objectives of financial statement and the accounting rules (standards) prepared for its drawing up.

As a logical consequence of this approach, all the entities, that believe it is not reasonable to expect the existence of dependent users, declare themselves as *non-reporting entities*. These entities are allowed to not apply most accounting standards, so to reduce the costs for the preparation of their accounts.

[13] However, the *small* (or *exempt*) *proprietary companies* are partially exempted from this requirement.

[14] Emended versions of this document have been issued in December 1999, in December 2001, in April 2005, in January 2007 and in June 2008.

[15] Modified by *Company Act 2006*.

[16] "This definition [of *reporting entity*] has been adopted in the Australian equivalents to IASB standards", (AASB, 2004, p. 1).

4.2 The Non-Reporting Entity solution

Until 2003, the *non-reporting entity* concept was indirectly formulated on the basis of the *reporting entity* definition from SAC 1. In October 2004, the *Institute of Chartered Accountants* (ICCA) issued the *Business Practice Guide: Financial Statements of Non-Reporting Entities*, that gave a positive definition of *non-reporting entity* and identified the main characteristics of its financial statement (the *Special Purpose Financial Report* – SPFR).

A *non-reporting entity* is an entity in respect of which there is (ICAA, 2004, pp. 3-4):

- No dependent users;
- Minimal separation of management and owners;
- No significant impact on external parties;
- No significant financial characteristics like size and indebtedness.

Moreover, it is interesting to underline that this document firmly evidence:

- the main role played by users and their needs in qualifying a *non-reporting entity*;
- the relevance of a careful cost/benefit analysis before deciding the compliance with an integral set of accounting standards by these entities.

In fact, the *Institute of Chartered Accountants* asserts that (ICAA, 2004, p. 3): "Unlike shareholders in reporting entities the shareholders of NREs are not primarily concerned with making investment decisions on the allocation of resources and therefore comparability is not a major concern. Rather the issue is the measurement of performance in a format that is readily understood by the primary users i.e. management and owners."; at the same time, it underlines that (ICAA, 2004, p. 4): "The BPG contains some simplifications of measurement principles to ease the compliance burden on small business. In deciding which modifications to make, we have been guided by the costs and other burdens that full compliance with AASBs places on smaller entities, in relation to the benefits that users who are typically closely involved with the business derive from the information provided".

These declarations gives also the possibility to underline that, differently from FRSSE, the size criteria are just marginally and incidentally linked with the definition of those entities that are exempted from complete adoption of accounting standards.

The evident attraction for the non-reporting entity concept should not hide the high applicative complexity associated with this kind of approach. Even if it is theoretically valuable to consider the users and their information needs as the main factor in order to assess the effectiveness of accounting requirements (standards), this approach could cause "oriented behaviors".

Valuing the existence of *dependent users* is a difficult decision. Managers and majority shareholders are the only suitable subjects to take properly this decision. At the same time, they are the same subjects that are strongly interested to qualify their company as a *non-reporting entity*, in order to minimize the costs of accounting information[17].

In fact, since the reporting entity concept was incorporated within the Australian accounting standards, there were several attempts to lessen possible "oriented behaviors" by the business management. These attempts culminated with the issue of an *Exposure Draft*[18] that proposed to unconditionally extend the compulsory adoption of all accounting standards to all the companies. Its adoption would have cancelled the "conceptual" benefits of the Australian solution, restoring only the formal level of differential reporting.

The Exposure Draft was not adopted because of the strong opposition of accounting profession[19], but nowadays the question is still open and there is a wide debate in Australian accounting context.

5. Conclusions

The extensive and more and more intense regulation in accounting context is probably the prevalent cause of raising the accounting standards overload issue.

By a brief analysis of Anglo-Saxon accounting literature, it is possible to claim that this phenomenon can be defined along two different but correlated perspectives:

1. the question of comparing costs and benefits of complying with accounting standards by small and/or privately held entities;
2. the competitive disadvantage for public accountants (CPAs) who serve these entities.

However, the substantial theoretical coherence in defining the accounting standards overload issue is not completely supported by empirical evidence that has often got totally opposite conclusions[20].

Nevertheless, the several Anglo-Saxon standard setters have always been very sensitive to this phenomenon, by proposing alternative approaches of differential reporting; unfortunately, they have not been able to find a shared and final solution, so that it remains still open.

Consequently, the words used by David Mosso (1983, p. 120) more than thirty years ago to describe the complex phenomenon of accounting standards overload are tremendously as current and extremely effective: "When I first encountered the subject,

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[17] An alternative solution to identify a *reporting entity* is given by: (Shannon R.P., 1992).

[18] It is the Exposure Draft n. 72 *'Changes to Application of Standards for Corporate Law Simplification'*, issued in 1996 by AASB.

[19] The 88% of *comment letters* were contrary to eliminate the *reporting entity* concept.

[20] "(…) I have to conclude that responses to research questions lend little or no support for CPAs' expressed concern about lack of relevance and only modest support for their expressed concern about overall cost-benefit deficiencies", Mosso (1983, p. 124).

Please go to paragraph n. 3 for more details of all empirical researches.

'standards overload' looked like the legendary Gordian knot, so intricate it couldn't be untied by any ordinary mortal. After five years of wrestling with the problem, however, I think maybe it isn't a Gordian knot after all – it looks more like a hangman's noose."

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