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The Theoretical Bases for the Preparation of Financial Statements for SMEs: the Case of Estonia

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Declaration:

Hereby I declare that this doctoral thesis, my original investigation and achievement, submitted for the doctoral degree at Tallinn University of Technology has not been submitted for any academic degree.

Liis Talpas

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MAJANDUS H50

Väike- ja keskettevõtete finantsaruannete koostamise teoreetilised alused Eesti näitel

LIIS TALPAS

TTÜ KIRJASTUS

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INTRODUCTION

How an entity presents information in its financial statements is very important because financial statements are a central feature of financial reporting – a principal means of communicating financial information to those outside an entity. Globalization and transnational business expansion has resulted in an increased need for uniform rules so that the financial statements in different countries are prepared on a similar basis, and there would be no opportunity for interpretation. Although at an international level different professional accounting organizations have made efforts to harmonize financial reporting rules, there has been a lot of criticism on the address of financial statements for many reasons. Firstly, there are too many alternative ways to report financial information in the financial statements (IASB, 2008). This makes it difficult to compare the financial statements of different entities, and provides opportunities to false conclusions about the success of the activities of the entity. Secondly, the entities in different countries have different demands on how to draft financial statements (European Commission, October 25, 2011). This situation complicates the interpretation of the entities' financial results and comparisons of financial reports at the international level. Thirdly, the financial reporting requirements set on companies often do not take into account the size of the company and this raises the question of the need for differential reporting (Cole *et al.*, 2012; Evans *et al.*, 2005; Collis *et al.*, 2001). Fourthly, what users review in the financial statements differs, and therefore, when drafting the financial statements, the company should bear in mind the interests of the most significant user groups (Cole *et al.*, 2012; Sian and Roberts, 2009).

Bearing the above criticism in mind it is crucial to analyse the financial accounting framework in Estonia and to investigate, whether the users of the financial statements in Estonia are experiencing the same problems. Taking into account that 99.9% of Estonian companies are small and medium-sized entities (SMEs) the author has focused the research on those particular companies. Estonia has a really high proportion of SMEs compared to other countries in the European Union (EU). According to the data provided by Eurostat, in 2010 Estonian SMEs created 75% of the value added (EU-27 average was 58%) and employed 79% of the total workforce in Estonian' non-financial business economy (EU-27 average was 68%) (Eurostat, 2013).

The research gap is that although analysing the needs of SME financial statements users and preparers is not new, it is underexplored in the context of Post-Soviet countries such as Estonia. This research is important to understand the causes affecting the development of the financial reporting system in emerging countries such as Estonia and to take into account the possible influences when developing a new accounting legislation in the future.

In addition, this doctoral thesis provides a comprehensive overview of the changes in Estonian accounting legislation from 1990 to 2012 using institutional theory. First of all, there are only few authors publishing about Estonian accounting issues and there is practically no accounting-related academic literature available, even at the local level in the Estonian language. Therefore, this doctoral thesis tries to fill in this gap and provides a thorough overview of the main changes. Secondly, this thesis uses institutional theory in analysing the country-specific factors affecting the development of financial accounting and reporting in Estonia, as an inter-play between practices, routines and institutions.

From international perspective this doctoral thesis provides a comprehensive overview about different equity theories and links them to the conceptual frameworks of the International Accounting Standards Board (IASB) and the Financial Accounting Standards Board (FASB). Although few authors have investigated conceptual frameworks using equity theories (Van Mourik, 2010a; Van Mourik, 2010b; Troberg *et al* 1995), its application is generally underexplored, especially from the perspective what are the objectives of financial reporting and who are considred to be the users of the financial stataments. In addition, the doctoral thesis aimes to provide an overview of the evolution of equity theories by identifying the prevailing theory of the period and determining the main users from whose point of view the financial statements should be presented.

The aim of this doctoral thesis is at first to formulate an understanding how current and future accounting standards that govern the preparation of SMEs' financial statements expect to meet the needs of users. Secondly, how should a complete set of financial statements that satisfies the needs of Estonian stakeholders look like.

Although the overall research question aims at identifying the needs of SME financial statement users and preparers in Estonia, one should take a wider approach to this matter. As Estonian' economy is not a closed system, one should analyse the international factors influencing the development and compilation of Estonian accounting standards. This also means identifying the underlying concepts of current accounting standards and linking them to a comprehensive theory.

The contribution of the thesis from international perspective is that the findings of this study have implications for regulators who are now considering the possibility of developing guidance for the SMEs. From the EU perspective, this research can provide valuable insights for member states, how to implement the new Accounting Directive 2013/34/EU.

In Estonia, the research is interest of organisations and individuals concerned with Estonian financial accounting guidelines (for example Estonian Ministry of Finance, Estonian Accounting Standards Board), as the doctoral thesis contains observations on the Estonian current system of financial accounting concepts and relevant suggestions for the future. So in general, this doctoral thesis potentially contributes to the accounting reforms evidence in emerging economies, its progresses and obstacles.

To achieve the aim of the doctoral thesis, the author has raised the following **research questions**:

- Is there an "accounting theory"? Should it govern the Estonian financial accounting framework and standards?
- What are the institutional pressures affecting the development of the financial accounting framework in Estonia?
- Who are the Estonian SME financial statement users and what information they use in analysing the SME financial statements?
- Do Estonian SMEs face barriers in realizing the benefits of accounting standards?
- What should a complete set of financial statements look like that satisfies the needs of SMEs and their financial statement users in Estonia?

To achieve the aim of the research the author studied the topic through theory and practice, and the results are observable through four chapters that explain, how the research was conducted and how the research questions were answered. How different chapters serve the purpose of achievening the aim of the research and answering to research questions, is described in Figure 1. The **methodological approach and methods used** are briefly explained below as they are included in the end of each chapter's description.

Chapter 1 of the dissertation intends to examine the philosophical foundations of the Conceptual Framework. At the international level, the question how to draft financial statements in a manner that would be suitable for their users has been also raised by the IASB located in United Kingdom and the FASB located in the United States of America. The objectives of financial reporting and qualitative characteristics of financial statements are determined by IASB's "*Conceptual Framework for Financial Reporting 2010"* (the Conceptual Framework) and FASB's "*Statement of Financial Accounting Concepts No. 8*". This is a document developed jointly by the IASB and the FASB that is intended to set forth objectives and fundamental concepts that will be the basis for development of financial accounting and reporting guidance.

According to Gore and Zimmermann (2007) without a framework, accounting standards might be based on the most convenient or agreeable solution to a particular issue, rather than a solution that is consistent with a unified theory of accounting. Therefore, Conceptual Framework should be the theoretical basis for the development of financial accounting and reporting guidance. Some authors believe that equity theories may provide a frame of reference for the objectives of financial reporting and to the presentation and measurement of information reported in the financial statements. Although according to Kam (1990) no comprehensive theory of accounting exists to measure income and capital properly, according to Van Mourik (2010a) there is always either a proprietary (income as measure of shareholder's and investor's increased wealth) or an entity perspective (income as a measure of the entity's performance and contribution) to the purpose of accounting and reporting. Therefore, the author believes that it is grounded to use equity theories as a theoretical

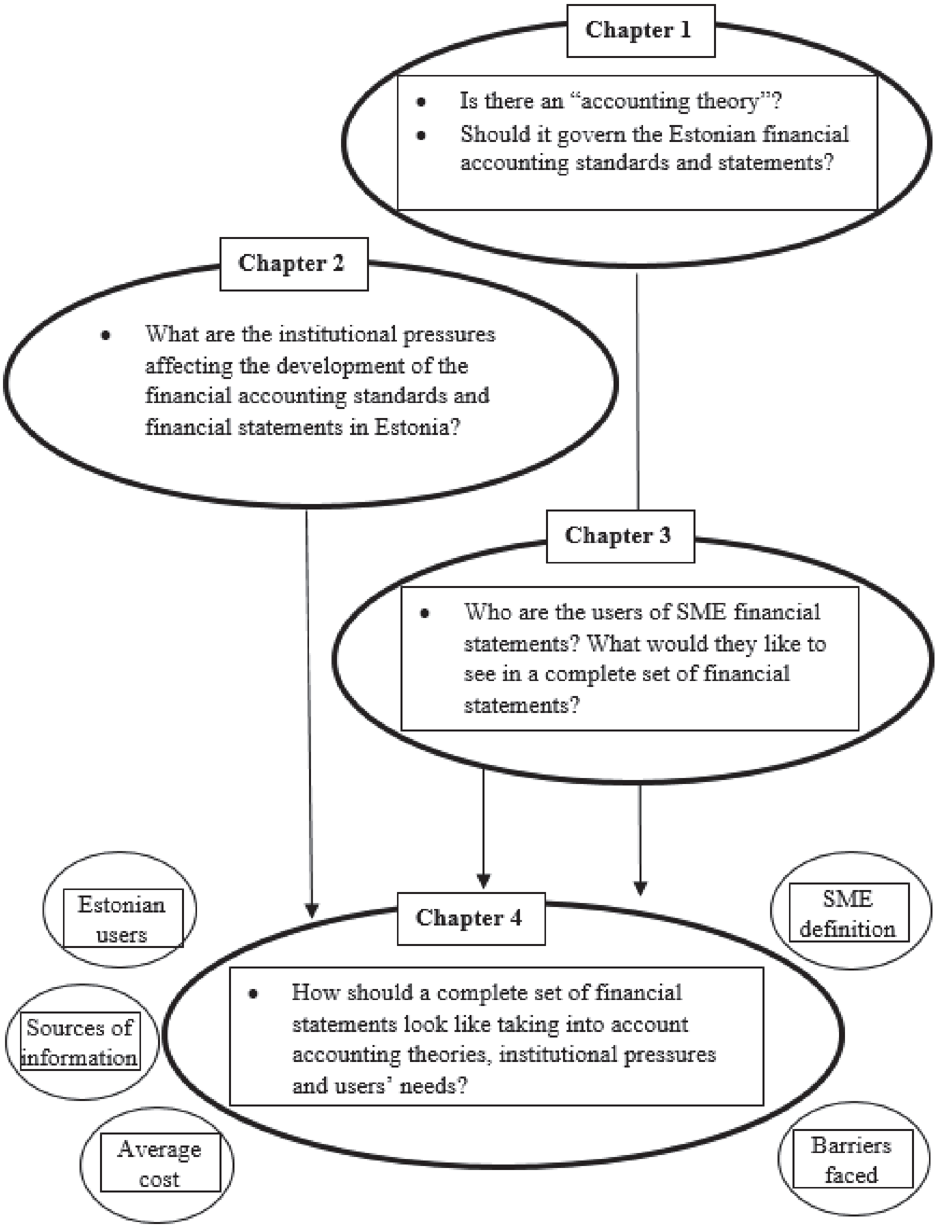

Figure 1. General framework of the thesis
Source: composed by the author

basis to interpret the conceptual frameworks of the IASB and the FASB or accounting legislation in general.

The author has used different equity theories – the proprietary theory, entity theory, enterprise theory and residual equity theory – to explore the theoretical concepts of the frameworks developed by the IASB and the FASB. Firstly, the author gives an overview of the first attempts to define financial accounting theory and concepts using equity theories giving an overview of characteristics inherent of each of them. Secondly, the author concentrates on the conceptual frameworks of the FASB and the IASB, which were designed to provide a basis for accounting standards. The author has chosen the guidance of the aforementioned organizations, because she believes that they may be one of the few international players being capable of developing an accounting theory. Further analysis is conducted to find out to what extent Estonian accounting legislation provides discussions about equity theories. This research aims at developing a stronger basis to formulate comprehensive Estonian accounting framework, including a more consistent use of the accounting point of view, to construct Estonian accounting standards. As a methodological approach, document analysis is used.

In Chapter 2, the author addresses how globalization and International Financial Reporting Standards (IFRSs) have affected the development of financial accounting and reporting in Estonia. This is important to determine the factors in addition to equity theories that influence the development of a country's accounting framework. This is interpreted through institutional theory. The integrity and usefulness of an institutional approach to explain and interpret accounting activities at the international level has been acknowledged by many authors.

The discussion part of Chapter 2 is presented in three sub-sections, divided between coercive, normative and mimetic institutional pressures. The author has analysed the coercive institutional pressure based on the Estonian accounting legislation from 1990 to 2012 and has divided the integration of Estonian financial accounting and reporting system into the international framework into three stages using the classification of Haldma (2003): (1) introductory stage (1990-1994), (2) system building stage (1995-2002), and (3) system improving stage (since 2003). After that the author has focused on the analysis of normative institutional pressure taking into account the impact of the Big 4 auditing companies have in the Estonian context. Finally, the author gives an overview of mimetic institutional pressures affecting the accounting and reporting system in Estonia. As a methodological technique the literature review and document analysis are used. For collecting examples and reactions to the changes in Estonia in light of the three institutional pressures, among other things the master theses and papers written by Estonian researchers have been used.

In Chapter 3 the goal is to give an overview about the users of financial statements of SMEs, their information needs, legal environment created for SMEs financial accounting and reporting purposes and to map the results. In preparing financial statements, it has always been an important issue on how much and in which form the information should be provided in order to allow for users to formulate opinions and make decisions that are important to them (Flint 1982). This is another way how to develop an accounting framework and compose accounting standards – by taking into account the user's perspective. This is what has been done, for example, by the IASB and the FASB, whose conceptual frameworks are based on decision usefulness approach. According to the IASB and the FASB, the financial statements should aim to provide both existing and potential investors, lenders and other creditors, with information about the company's activities, which is useful to make investment decisions related to resources. Decision usefulness approach in financial reporting is an approach of the preparation of financial accounting information that emphasizes on the theory of investor decision making in order to infer the nature and types of information that investors need (Staubus 2000, 159). However, in practical means, the theory of satisfying users' needs remains a relatively empty one when little is known about these needs in practice (Lee 2009, 156). The author reviews the users of financial statements and their information needs as the "inputs" for developing financial reporting standards. Only when it has been possible to define the inputs, it is possible to define the "output" – prepare standards or define financial statement formats that would govern financial reporting.

Firstly, the Chapter starts with defining the term "SMEs" that will be used in this dissertation. The author believes that this is an important thing to do, because the basis for defining SMEs can be qualitative and/or quantitative and the prior research about SMEs has used different measures when analysing SMEs.

Secondly, the author has concentrated on the "Big GAAP" versus "Little GAAP" debate to demonstrate the need for differential reporting in respect of SMEs based on the accounting literature. According to Collis and Jarvis (2000), a common argument in the debate is that large companies have complex transactions and that they provide highly aggregated information, which requires specific rules to deal with them (e.g. accounting for business combinations). However, such complexities are rarely relevant to small companies. Therefore, further analysis of *pros* and *cons* of differential reporting is needed to justify the creation of separate accounting standards for SMEs.

Thirdly, SMEs also face many barriers in realizing the benefits of accounting standards. Studies have shown that SMEs could play an important role in standardisation, but are often hampered by a number of factors. These barriers include a lack of awareness of standards relevant to their business, a perception that they are more relevant to large businesses and a lack of human and financial resources to both develop and make use of standards. As a result, participation by SMEs in the standardisation process (accessing information, participating in committees, implementing and using standards) is typically low, relative to their importance within the economy. Because participation by SMEs in standardisation is lower than desirable, there is a risk that published standards do not take fully into account the needs or interests of SMEs. This can further exacerbate the issue of relatively few SMEs using and implementing relevant standards fully and effectively. As a result, SMEs and the economy more widely are not fully reaping the benefits offered by standards and may even have unnecessary requirements placed on them (European Commission 2012).

Fourthly, the Chapter covers the previous research on the users of the SMEs and their information needs. Although the author aimed to review the previous literature concerning only about the financial statement users and uses from the viewpoint of SMEs as defined in Chapter 3.1 of this dissertation, it soon became quite obvious that the prior research does not follow the same criteria when defining SMEs. This is due to the fact that the studies under investigation have been conducted at different times, in different countries depending heavily on the national legislation and on the information available about non-public/private/SME companies. In addition, care must be taken when comparing studies, because different researchers have used different ways to capture the real users. Some studies have directly asked companies (i.e. preparers) whom they consider to be the recipients (i.e. users) of the company's annual report. Others have posted their questionnaire on a webpage and have given respondents an option to choose which viewpoint (i.e. creditor, supplier, customer) they take when they use the financial statements of a company. Some have used an expert group to give an overview of the possible financial statement users of small enterprises and their information needs. The uses of financial statements have been analysed by bearing the main user groups in mind. The author has also pointed out the criticism other authors have raised in respect of previous researches about SME financial statement users and uses.

Finally, the author has concentrated on the accounting legislation affecting SMEs in the EU and its member states and has also analysed the developments of SME accounting legislation at the international level. The author believes that it is important to analyse these aspects as the EU and IASB are considered to be the coercive institutional pressures affecting the Estonian accounting framework. This analysis also gives an option to compare future perspectives of the Estonian SME accounting environment to the options available in the EU accounting legislation as there may be legislative settings we can take over or modify to adapt to the needs of Estonian SMEs.

The overview in Chapter 3, analysing the information needs of financial statement users, is the basis for Chapter 4. In Chapter 4, the author has focused on identifying and defining the financial statement users and their information needs in Estonia from the perspective of SMEs. This is done in orfer to understand, whether the current financial reporting standards in place in Estonia satisfy the needs of the users. Chapter 4 also covers other issues and questions identified in Chapters 1, 2 and 3 of the dissertation. By finding out the needs of users and preparers of financial statements, i.e. what statements they consider to be the most important, one can draw parallels with equity theories discussed in Chapter 1. Investigating whether many Estonian SMEs have to report to parent companies based on their specific rules helps to identify the mimetic pressures discussed in Chapter 2.

In Chapter 4, the author has carried out an online survey among Estonian SMEs. In conducting the online survey, the author has adopted the approach taken by Collis (2008) when defining the users of SME financial statements in Estonia. The latter asked the preparers of financial statements, who the users are, who receive financial statements directly from the company, and who these users are, who are considered to use the published financial statements of the company. The preparer can also constitute to be a user, for example the user of financial statements as a competitor, creditor, customer or potential investor, and therefore, give insights to what they find important to be included in the financial statements. This Chapter also includes questions about the need for differential reporting in Estonia, the satisfaction with current reporting model and the potential costs related to the preparation and publication of the annual report. These questions form part of the issues raised in the thesis and as these can only be asked from the financial statement preparers (i.e. management and accountants), this supports the view of choosing preparers as the starting point for analysing accounting standards, including the user's perception.

The empirical study is unique in Estonia, as nothing similar has been conducted by other researchers among SMEs to find out their needs and preferences in respect of financial statement preparation. Thus, a research gap definitely exists in that respect. Also, the empirical research is a valuable insight to understand the preferences of SME financial statement users and preparers not only in Estonia, because by taking into account the results of this survey and comparing them with research conducted in other countries, one can draw more comprehensive conclusions on what financial statements of SMEs should look like in the future.

The total number of answers received in the empirical research was 93, which was divided between micro, small and medium sized companies as follows: 39 answers from micro entity representatives, 40 from small companies and 14 from medium-sized companies. This grouping was made by the author based on the answer to question 1, which asked the respondents to indicate the main financial figures of the company for 2012 and 2013 (including total revenues, total assets and the average number of employees) and based on the SME criteria defined in European Accounting Directive 2013/34/EU. The 93 respondents were divided as follows: 17 male and 76 female respondents. The average respondent was 40–49 years old and had 16–20 years of work experience in his/her field of activity. The author recognises that this survey, like most of the studies concerning users, has some limitations, but this does not diminish the value of the survey in general to provide insight to the SME financial reporting.

All four chapters of the thesis compliment each other in order to give a comprehensive overview of the changes in the Estonian accounting legislation, standards and practices. In this thesis empirical research is used to provide valuable insight into how current and future accounting standards that govern the preparation of SMEs' financial statements expect to meet the needs of users. Moreover, the thesis provides a framework for a complete set of financial statements that satisfies the needs of the Estonian stakeholders.

Abbreviations

AAA	American Accounting Association
AICPA	American Institute of Certified Public Accountants
APB	Accounting Principles Board
ASBG	Accounting Standards Board Guideline
DP	Discussion Paper
DS	Developed Standard
EAA	Estonian Accounting Act
EAoA	Estonian Association of Accountants
EASB	Estonian Accounting Standard Board
EBA	Estonian Board of Auditors
ECC	Estonian Commercial Code
EFRAG	European Financial Reporting Advisory Group
ED	Exposure Draft
FASB	Financial Accounting Standards Board
FEE	Fédération des Experts Comptables Européens
GAAP	Generally Accepted Accounting Principles
GAPSE	General Accounting Principles for Smaller Entities
IASB	International Accounting Standards Board
IASC	International Accounting Standards Committee
IFRS	International Financial Reporting Standards
IMF	International Monetary Fund
SFAC	Statement of Financial Accounting Concepts
SMEs	Small and Medium-Sized Entities

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1. THE THEORETICAL BASIS FOR ACCOUNTING AND FINANCIAL REPORTING FROM THE PERSPECTIVE OF EQUITY THEORIES

The aim of Chapter 1 is to examine philosophical foundations of the Conceptual Framework, which should be the theoretical basis for the development of financial accounting and reporting guidance. Some authors believe that equity theories may provide a frame of reference for the objectives of the financial reporting and to the presentation and measurement of information reported in the financial statements. Therefore, the author has used equity theories – the proprietary theory, entity theory, enterprise theory and residual equity theory – to explore the theoretical concepts of frameworks developed by the IASB and the FASB. Firstly, the author analyses how the term "theory" is interpreted in the context of accounting and whether in the current accounting literature a reference to "accounting theory" exists. Secondly, the author gives an overview of the first attempts to define financial accounting theory and concepts using equity theories giving an overview of characteristics inherent of each equity theory. Thirdly, the author concentrates on conceptual frameworks of the FASB and the IASB, which were designed to provide a basis for accounting standards. The author has chosen the guidance of the aforementioned organizations, because these organizations may be one of the few international players being capable of developing a comprehensive accounting theory. Further analysis is conducted to find out to what extent Estonian accounting legislation provides discussions about equity theories. This research aims at developing a stronger basis to formulate a comprehensive Estonian accounting framework, including a more consistent use of the accounting point of view in Estonian accounting standards.

1.1. Is There an "Accounting Theory"?

The word "theory" is used at different levels in the literature of accounting. References to "accounting theory" may mean purely speculative interpretations or empirical explanations (Glautier *et al* 1997, 23). Many authors argue that there is no generally accepted "accounting theory" currently even though many attempts have been made to formulate one (Riahi-Belkaoui 2004, 83). According to Hendriksen (1982, 39):

> "Accounting theory may be defined as logical reasoning in the form of a set of broad principles that (1) provide a general frame of reference by which accounting practice can be evaluated, and (2) guide the development of new practices and procedures. Accounting theory may also be used to explain existing practises or to obtain a better understanding of them. But the most important goal of accounting theory should be to provide a coherent set of logical principles that form the general frame of reference to the evaluation and development of sound accounting practice".

The word "theory" itself gives rise to misunderstanding, and may mean different things to different people. This arises because explanations are made at different levels. At one extreme, explanations are purely speculative, resulting in speculative theories. To the natural scientist, speculative theories are not generally theories at all and explanations have to be conclusive before they are given the status of theories. To this end, their assumptions require verification by the test of experience. Empirical theories are constructed by the process of verifying assumptions, or hypotheses, through the test of experience. This process is known as the "scientific method". (Glautier *et al* 1997, 23)

But the role played by theory in accounting is very different from that played in the natural sciences, where theories are developed from empirical observations. The converse is the case in accounting, since practice may be changed to accommodate theory. For example, accountants can change their practises relatively easily. Therefore, it becomes an essential problem for accountants to know how accounting practices should be developed in the future, since it is possible to change practices to fit the theories. (Glautier *et al* 1997, 24)

Some authors make a clear distinction between "theories of accounts" and "accounting theories". In English, the term "theories of accounts" is often equated with "bookkeeping theories" to distinguish it from "accounting theories" which has less technical and more scientific implications (Mattessich 2008, 324). The numerous "theories of accounts" aimed at finding the basic rules for keeping books (Mattessich 2008, 23). Porwal (2001, 100) calls the "theories of accounts" also the theoretical concepts of accounting that are self-evident statements or axioms and that portray the nature of accounting entities operating in a free economy characterized by private ownership of property. The nature of the entity and the interests in the entity may be classified according to proprietary theory and entity theory. These are also called theories explaining equity (Porwal 2001, 105). According to Napier (2013) the various "accounting theories" can be divided into two broad, but overlapping, groups reflecting the main purpose for which the theories have been developed. Some theories are intended to provide a structure for understanding existing accounting practice, usually with a view to its improvement. Such theories may be labelled "prescriptive" or "normative", and have sometimes been classified as "theories *of* accounting". Other theories also aim for an understanding of existing accounting practice, but here the objective is to explain the behaviour of those who prepare and use financial reports of businesses and not-for-profit entities, and to predict the accounting choices that preparers and users may make. Such theories may be labelled "descriptive" or "positive'" and come within the classification "theories *about* accounting". (Napier, 2013)

The "theories of accounts" and their controversies were predominantly a Continental European phenomenon, though American authors were also interested in it, and had their own pertinent disputes (Mattessich 2008, 26-27). The "proprietary theory" and the slowly emerging "entity theory" (both conceived already in the 19^{th} century) had become considerably important for the modern accounting theory, and not only in Continental Europe (Mattessich 2013, 6). Equity theories were a popular topic of journal articles from the 1930s to the 1960s. In the 1970s equity theories started collecting dust in accounting theory textbooks or disappeared altogether from most accounting academics and practitioners' frame of reference. (Van Mourik, 2010a)

However, some authors believe that equity theories may provide a frame of reference for the objectives of the financial reporting, and thereto the presentation and measurement of information reported in the financial statements. Equity theories provide different views in answer to the question whose point of view should be taken in the accounting process of companies (Kam 1990, 302). The point of view taken in the accounting and reporting process determines the perspective from which accounting transactions are analysed and the way in which they are recorded and accounted for (Van Mourik 2010a). According to Hendriksen and Van Breda (1992, 766) equity theories interpret the economic position of the enterprise in a different way leading to a different emphasis in disclosing the interests of stakeholders as well as different concepts of income. But when viewing the applicability of the various theories of equity, it is important to remember that the purpose of a theory is to provide a rationale or explanation for some action (Schroeder *et al* 2009, 498).

From various theories of accounts, the proprietary theory and later the slowly emerging entity theory have been interpreted as attempts "to define a conceptual framework based upon logic to replace "rationalization" (Previts and Merino 1979) as used in personification of accounts". The central feature of the proprietary theory was its emphasis on the capital account and capital preservation, and later, on the balance sheet, which grew to assume a more dominant position. In this theory the capital account was no longer considered to be a residual account, but became firmly identified with the owner – just as the entire firm was considered his possession, not something apart from him. Hence, attention shifted from mere transactions to making profit for the owner – a crucial step in the direction towards the twentieth-century accounting theory. (Mattessich 2008, 27-28)

Representatives of the proprietary theory were James W. Fulton (1800) and Cronhelm (1818) from Great Britain, Germans Augspurg (1852) and Löw (1860), the Americans Thomas Jones (1841) and, later, Sprague (1907) as well as Hatfield (1909). In Switzerland, Hügli (1887, 1900) elaborated the work of earlier German authors, became the leading exponent of the *proprietary point of view*, and demonstrated the accounting equilibrium by means of algebraic equations. (Mattessich 2008, 28)

A crucial step in accounting theory was the slow but steady acceptance of the entity theory by series of scholars. Its main characteristics were the conceptual and often legal separation of the firm from its owners, as well as a clear distinction between capital and annual income, and the emphasis of the latter. Assets were occasionally regarded to be future expenses, and the previous distinction between ownership claims and debt claims may become blurred, as both were now accepted as equities (though with different legal implications). A further characteristic of this theory, as later formulated by Paton, required the interest on debt to be considered a distribution of income. This is still a point of controversy, as in some European countries not only interest on debt but also on owners' capital, as well as the owners' salaries (sometimes even corporate taxes), are considered expenses and not distributions of income. (Mattessich 2008, 29)

The entity theory – though traced back by Littleton (1933) to the sixteenth century – definitely emerged before the mid-1800s, but gained popularity only after the turn of the twentieth century through Niklisch (1903, 1912) and other authors (Mattessich 2008, 29). One may point out that the controversy between proprietary versus entity theory continued until the middle of the twentieth century. The importance of this controversy may have been exaggerated, as Zeff (1978) believed. But few would deny the needs of modern corporations (with their numerous stockowners, limited liability, transferability of interests, and, above all, separation between ownership and management) are better met by the entity theory than its proprietary competitor. (Mattessich 2008, 30)

Looking at the English language literature one gets the distinct impression that most of the researchers on this issue believe that there is only one correct answer to the question of whose perspective should be taken in the accounting process. Those who believe that accounting should be conducted from the shareholders' point of view would support the proprietary theory or a variation thereof (Hatfield, 1909; Sprague, 1913; Husband, 1938, 1954; Staubus, 1959). Those who believe that the accounting process should be conducted from the business entity's view would adhere to a form of entity theory (Gilman, 1939; Paton and Littleton, 1940; Chow, 1942; Suojanen, 1954, 1958; Seidman, 1956; Raby, 1959; Li, 1960a, 1960b, 1961, 1963). (Van Mourik 2010a)

In the following discussion, the author would like to investigate how the adoption of a particular equity theory has influenced the development of accounting and reporting procedures and principles. The aim of the author is to review accounting literature in the English language starting from the early theorists to the developed conceptual framework of the IASB and the FASB in order to understand the implications of proprietary and entity theory for financial accounting and reporting. Although the decision usefulness approach underlies the conceptual frameworks of the IASB and the FASB (Scott 1997, 2), one can argue that the reason why the IASB and the FASB are speaking of a conceptual framework of accounting is that it does not consider the necessity for logical derivation (Kam 1990, 490). Presently, we have an intuitive comprehension of the various statements that make up a theory of accounting, but this is not a comprehensive theory. A comprehensive theory of accounting should provide rules for recognizing certain relevant economic objects and also provide a basis for judging whether a given practice is "good" or "bad". In other words, a comprehensive theory should tell us how to measure income and capital properly (Kam 1990, 490). Today, all that has remained of "financial accounting theory" in the active literature are conceptual frameworks intended to support principles-based standards (Lee 2009, 141).

Although according to Kam (1990) no comprehensive theory of accounting exists to measure income and capital properly, according to Van Mourik (2010a) there is always either a proprietary (income as a measure of increased shareholder and investor wealth) or an entity perspective (income as a measure of the entity's performance and contribution) to the purpose of accounting and reporting. Therefore, the author believes that it is grounded to use equity theories as a theoretical basis to interpret the conceptual frameworks of the IASB and the FASB or accounting legislation in general. Consequently, choosing a perspective of the company (i.e. either the proprietary or entity perspective) is essentially a political instead of technical decision as it has clear consequences for the perceived importance of stakeholders' financial accounting information and income distribution needs (Van Mourik 2010a).

Further analysis is divided into three parts. Firstly, the author gives an overview of the first attempts to define financial accounting theory through equity theories by giving an overview of characteristics inherent of each equity theory. Secondly, the author concentrates on the conceptual frameworks of the FASB and the IASB, which were designed to provide a basis for accounting standards. Thirdly, the author analyses Estonian accounting legislation from the viewpoint of equity theories.

1.2. First Attempts to Define the Conceptual Framework for Accounting Using Equity Theories

In most of the continental European countries and Japan, accounting has been more the servant of the state (e.g. for collecting taxes). In the Anglo-Saxon world, theory was traditionally of little importance in accounting practice (Nobes *et al* 2004, 29). Prior to the 20th century accounting practices were initially developed in response to changing economic conditions, and no attempts were made to establish a "theory of accounting". Subsequently, individual writers and later authoritative bodies undertook efforts to explain the goals of accounting. Most of the initial approaches were more descriptive of existing practice than normative in nature. Later efforts have attempted to develop and build a normative theory of accounting (Schroeder *et al* 2009, 29).

The early 1900s in the United States of America can be characterized from the point of view of *proprietary theory* (Schroeder *et al* 2009, 498), although this point of view dates from the eighteenth century, when a few textbook writers attempted to present the logic of accounting based on the "purpose of the firm, the nature of the capital and the meaning of the accounts from the owner's viewpoint" (Kam 1990, 302). According to the proprietary theory, the firm is owned by some specified person or group. The ownership interest may be represented by a sole proprietor, a partnership, or a number of stockholders. The assets of the firm belong to these owners, and any liabilities of the firm are also the owners' liabilities. Revenues received by the firm immediately increase the owner's net interest in the firm. Likewise, all expenses incurred by the firm immediately decrease the net proprietary interest in the firm (Hendriksen and Van Breda 1992, 770). Interest and income tax are also viewed as expenses. This theory holds that all profits and losses immediately become the property of the owners, and not the firm, whether or not they are distributed. Therefore, the firm simply exists to provide the means to carry transactions for the owners, and the net worth or equity section of the balance sheet should be viewed as (Schroeder *et al* 2009, 498):

$$\boxed{\text{ASSETS} - \text{LIABILITIES} = \text{PROPRIETORSHIP}}$$

From the perspective of proprietary theory, the balance sheet is the most important financial statement to assess the wealth of the owners. The most appropriate layout of the balance sheet would be the vertical net assets format arranged in order of increasing liquidity as is common in the United Kingdom (UK). A category in-between liabilities and capital would not be acceptable as it would hamper the determination of net assets (Van Mourik 2014, 32). In a strict proprietary view, the income statement follows the all-inclusive concept of profits, and all income for the period would be distributed to the shareholders because retained earnings do not exist (Van Mourik 2014, 32). Income from the proprietor's perspective or in case of public limited companies the shareholders' perspective is a net worth concept that expresses the increase in wealth using the asset – liability approach. Some believe that assets and liabilities should therefore be measured at current cost or fair value rather than historical cost. For example, Hatfield (1909) espoused valuation of inventory on a going concern basis (i.e. current cost), and valuation of fixed assets on a historical cost basis as long as depreciation is taken into account (Van Mourik, 2010a). Hatfield's "*Accounting*" (1909) was arguably the first comprehensive attempt to explain financial accounting from theoretical perspective. Hatfield advocated a proprietary approach to accounting and started with the balance sheet before moving on to assets and valuations, intangible assets, capital, and liabilities. As a proprietary theorist, Hatfield regarded liabilities as negative assets (Lee 2009, 144). In other words, the all-inclusive concept of income (clean surplus relation) applies to the proprietary view, which means that holding gains and losses on assets and liabilities as well as non-recurrent profits or losses should be included in the determination of income for the period. Therefore, one can argue that the proprietary theory forms the basis for the comprehensive income concept (Hendriksen and Van Breda, 1992), which is advocated by the the FASB and the IASB (Van Mourik, 2010a).

With regard to consolidation, Baker *et al* (2005) take the view that the proprietary concept results in a pro rata consolidation. The parent company consolidates only its proportionate share of the subsidiary's assets and liabilities (Van Mourik, 2010a). In consolidating financial statements, the parent company method is used in the proprietary concept. The parent company is seen as owning' the subsidiary. Minority interests, from the point of view of the "owner" of the subsidiary, represent the claims of a group of outsiders. For non-consolidated long-term investments the equity method is the appropriate approach under the proprietary theory (Kam 1990, 304)

The proprietary theory also holds an agency concept within. In a traditional agency setting financial reports are prepared by the managers for the purpose of providing information to the proprietors on the basis of which, the managers were held accountable for their stewardship (Van Mourik, 2010a). Therefore, proprietary theory assumes that the primary function of financial accounting and reporting is to mitigate the agency costs between the corporation's proprietors and managers (Van Mourik 2014, 34).

Under the proprietary theory, financial reporting is based on the premise that the owner is the primary focus of a company's financial statements. The proprietary theory is particularly applicable to sole proprietorships where the owner is the decision maker. The proprietary view of accounting was developed at a time when business firms were small and were mainly proprietorships and partnerships (Kam 1990, 305). When the form of an enterprise grew more complex, and the ownership and management separate, this theory became less acceptable (Schroeder *et al* 2009, 498). However, many of today's accounting practices are still strongly affected by this concept and imply that retained earnings are the net wealth of the stockholders. The comprehensive income, which includes all items affecting the net wealth, is one of the accounting practices that reflects the influence of the proprietary theory (Hendriksen and Van Breda 1992, 770).

Although debates about issues such as the existence of a science of accounting and the need to develop a theoretical framework began to appear in the early 1900s, the first attempts to develop accounting theory in the United States have been attributed to William A. Paton and John B. Canning (Schroeder *et al* 2009, 29). Paton's work, based on his doctoral dissertation, was among the first to express the view that all changes in the value of assets or liabilities should be reflected in the financial statements, and that such changes should be measured on a current value basis. He also maintained that all returns to investors (both dividends and interest) were distributions of income, and consequently he espoused the *entity concept* rather than the prevailing proprietary concept (Schroeder *et al* 2009, 30). The entity theory was formulated in response to the shortcomings of the proprietary view concerning the corporation (Kam 1990, 305). From an accounting standpoint, the entity theory can be expressed as (Schroeder *et al* 2009, 499):

$$\boxed{\text{ASSETS = EQUITIES}}$$

The entity theory is a point of view toward the firm and the people concerned with its operation. This viewpoint places the firm, and not the owners, at the centre of interest for accounting and financial reporting purposes. The essence of the entity theory is that creditors as well as stockholders contribute to the resources of the firm, and the firm exists as a separate and distinct entity apart from these groups. The assets and liabilities belong to the firm, and not the owners (Schroeder *et al* 2009, 499). The entity theory makes no distinction between debt and equity (Schroeder *et al* 2009, 500) and all retained earnings belong to the entity, not to the shareholders (Van Mourik 2010a). Only paid in capital belongs to the shareholders (Van Mourik 2014, 33). The entity view of the publicly held corporation considers the income statement the primary statement as it enables assessment of performance over the period, and the calculation of dividends for distribution and earnings to be retained in the company (Van Mourik 2014, 33). Entity theory assumes that an additional function is to reconcile the corporation's financial stakeholders conflicting interests by correctly determining income for distribution (Van Mourik 2014, 34). The balance sheet was secondary as it was not meant to indicate the firm's value, but rather to show the company's assets and all the stakeholders' interests in order to give an indication of solvency and the security of any assets pledged as collateral. Prudence and reliability were probably the overriding principles in the entity view (Van Mourik 2014, 33).

Many early writers associate the revenue-expense approach with the entity theory and accrual accounting with historical costs. Corporate income taxes are not considered a form of double taxation. Lorig (1964, 572, referred through Van Mourik 2010a), for example, considers cost the best basis for asset valuation under the entity theory. Controlling and non-controlling shareholders are viewed as two separate groups with an equity stake in the consolidated entity, neither of which is emphasised over the other. The full amounts of assets and liabilities are combined in the consolidated balance sheet. Consolidated net income is made up of a combined figure that is allocated between the controlling and non-controlling interest groups. (Van Mourik 2010a)

An early contribution to the entity theory in financial accounting was made by Dickinson in 1906. Dickinson was a partner in Price, Waterhouse and Company in the US and in the UK and did much to develop American institutionalised public accountancy. He concerned with identifying the income and financial position of a group of companies regarded as one economic entity. (Lee 2009, 143)

The most significant work in the 1940s about the entity theory seems to have been Paton and Littleton's (1940): "*An introduction to corporate accounting standards*". It was the first codification of accounting principles to be developed deductively rather than a series of generalization of practice. Paton and Littleton put income determination into the foreground and regarded the values of assets as residuals (unexpired costs). Despite initially sympathizing with replacement costs, the authors ultimately yielded for practical reasons to historical costs and the realization principle (Mattessich 2008, 173). The principal objective of financial accounting was seen as periodically reporting on managerial performance in terms of its "efforts" (costs) and "accomplishment" (revenue). Although practitioners and academics were not convinced by the entity approach of Paton and Littleton, the importance of their study is demonstrated by the fact that many of its basic ideas remain in the conceptual framework and accounting standards today. (Lee 2009, 147)

Van Mourik (2010a) believes that the work of Paton and Littleton lies between the proprietary and entity view that she called *the equity view*. It is an entity perspective because it sees the entity as independent from the owners. It analyses most transactions with respect to their effect on the entity and determines income by the revenue-expense approach. However, it also resembles a proprietary perspective because it sees management as the shareholders' agents, stresses the residual nature of shareholders' interests, and thus it focuses primarily on the information needs of investors, particularly investors in equity capital and considers retained earnings as belonging to common shareholders rather than to the entity. (Van Mourik 2010a)

Although the equity view considers the business to exist as an entity separate from its founders or owners, the balance sheet equation under this view as found in Hendriksen and Van Breda (1992, 771) describing the entity view is as follows (Van Mourik 2010a):

ASSETS = DEBT CAPITAL + STOCKHOLDERS' EQUITY CAPITAL

To the extent that there is a sharp distinction between debt and equity in the accounting for transactions with shareholders, the equity view becomes a proprietary view instead of an entity view. Such a sharp distinction is necessary to maintain that there can be non-reciprocal external transfers, and that the entity cannot have equity in itself. Inconsistencies in accounting for external transfers arise from the fact that it has been impossible to settle the debate on which mutually exclusive concept of income must be applied in accounting standards and practice. One concept sees income as a measure of performance, and the other views income as an enhancement of investors' wealth (agency perspective). The former is expressed as the revenue-expense approach, specific to entity theory, and the latter takes the form of the asset-liability approach to income determination, specific to proprietary theory. (Van Mourik 2010a)

In the 1930s and 1940s, significant contributions to the development of the conceptual framework of accounting were also made by DR Scott in the United States (Schroeder *et al* 2009, 30). He saw accounting as encompassing other important functions, such as managerial control and the protection of interests of equity holders. He also viewed accounting as having both an internal and an external control function to act for the protection of various economic interests such as stockholders, bond holders, and the government. Scott supported Paton's earlier acceptance of the entity theory and went on to emphasize that accounting must meet the needs of external users. This view is an example of why Scott was considered an outsider, because the prevailing view was that accounting should be designed to benefit the firm's management or proprietor (the proprietary theory) (Schroeder *et al* 2009, 31). Even a cursory review of Scott's work reveals how far ahead of his time he was. It was not until much later that the deductive approach to accounting theory DR Scott had advocated since the early 1930s began to be employed by authoritative standard-setting bodies (Schroeder *et al* 2009, 32).

In the mid-1930s professional organizations became interested in formulating a theory of accounting. In 1936 American Accounting Association (AAA) released a working paper, whose goal was to provide guidance to recently established Securities and Exchange Commission (SEC), but it was widely criticized by academics as relying too heavily on the historic cost model and the convention of conservatism (Schroeder *et al* 2009, 32). In 1940, the AAA published a new study. While this study also continued to embrace the use of historical cost, its major contribution was the further articulation of entity theory (Schroeder *et al* 2009, 33).

In 1959, Staubus introduced another version of proprietary theory – *the residual equity theory*. The residual equity theory is a variation of proprietary theory which explicitly takes into account the change in the nature of the business entity from a legal view when a business becomes insolvent. It is also the view that is closest to the legal approach of the company, insolvency and tax laws (Van Mourik, 2010a). This theory is also referred to as the investor theory because of the idea that accounting functions and financial statements should take the point of view of investors (Kam, 1990, 313). The purpose of financial reporting according to Staubus (1959, 6) is to provide any accounting information that will be of assistance in making a choice between investing and not investing. It must be information related to the times and amounts of the investor's future cash receipts from the investment relationship. Accounting and financial reporting should take the point of view of investors because the function of financial reporting is to provide information to suppliers of capital. The accounting equation according to the residual equity theory is (Staubus 1959, 13):

ASSETS – SPECIFIC EQUITIES = (LIABILITIES + PREFERRED STOCK) = RESIDUAL EQUITIES

In normal business situations specific equities include the claims of creditors, long-term lenders and preferred shareholders. Transactions are analysed, recorded and accounted for as to their effect on the business's residual equity holders, usually the common shareholders. (Van Mourik, 2010a)

In 1959 Accounting Principles Board (APB) was established, which replaced the previous authoritative body of accountancy in the USA, the CAP (Committee on Accounting Procedure). In 1961, the APB published the postulates study called "*Accounting Research Study No. 1*", which consisted of a hierarchy of postulates (three groups) encompassing the environment and accounting (Schroeder *et al* 2009, 34). The accounting postulates were designed to act as a foundation and assist in constructing accounting principles (Schroeder *et al* 2009, 35). But the general reaction to this study was that it did not serve any useful purpose (Schroeder *et al* 2009, 36). Although the APB published another series of studies, it was finally faced with the same problem that daunted its predecessor, the CAP, when it dealt with issues case by case without any underlying foundation on which to base decisions (Schroeder *et al* 2009, 37). Later in the mid-1960s the APB engaged in another attempt to develop accounting theory. A committee was formed that was given the charge to enumerate and describe the basic concepts to which accounting principles should be oriented, and to state the accounting principles to which practices and procedures should conform. The original intention of this project was to develop a comprehensive theory of accounting. The published statement "*Accounting Principles Board Statement No. 4*" started off well by advocating the user approach and defining accounting as "a service activity. Its function is to provide quantitative information; primarily financial in nature about economic entities that is intended to be useful in making economic decisions". It has been stated by Most (1982, 111) that the idea to place the users' needs and decision-usefulness on the centre of investigation comes from Staubus' pioneering works ("*Theory of Accounting to Investors*" 1961). The APB also concluded that "users of financial statements should be knowledgeable and understand the characteristics and limitations of financial statements". Despite the promising start, in the following years the committee came up with what was basically a description of existing practices. (Schroeder *et al* 2009, 37)

The criticism of the APB resulted in yet another attempt to develop a conceptual framework of accounting. Young (2006) states that one of the earliest contributions to the development of contemporary conceptual frameworks was the 1966 AAA document entitled "*A Statement of Basic Accounting Theory*". The intense debate sparked by the publication of this document subsequently led to the American Institute of Certified Public Accountants (AICPA) commissioning a select group in the spring of 1971 to study the objectives of financial statements. In 1971, AICPA formed the Trueblood Committee, which was charged with proposing fundamental objectives of financial statements to guide the improvement of financial reporting. It was to find answers to four questions (Schroeder *et al* 2009, 39):

1. Who needs financial statements?
2. What information do they need?
3. How much of the needed information can be provided by accountants?
4. What framework is needed to provide the information needed?

The Trueblood Committee adopted a normative approach as well as a user orientation in maintaining that "financial statements should serve primarily those users who have limited authority, ability or resources to obtain information and who rely on financial statements as their principal source of information about an enterprise's economic activities". The committee report specified the following information needs of users (Schroeder *et al* 2009, 39):

1. Making decisions concerning the use of limited resources;
2. Effectively directing and controlling organizations;
3. Maintaining and reporting on the custodianship of resources;
4. Facilitating social functions and controls.

The report by Trueblood Committee is considered to be the origin of contemporary reflection on financial accounting standards (Archer 1992). The Trueblood Committee concluded its work with specified twelve objectives and seven qualitative characteristics of financial reporting (Riahi-Belkaoui 2004, 173). Taking into account the focus of this Chapter, the author of the current thesis has concentrated on five of these twelve objectives of financial reporting (from Riahi-Belkaoui 2004, 169-172, the numbering is the author's, not the Trueblood Committee's):

1. The basic objective of financial statements is to provide information on which to base economic decisions.
2. Financial statements should serve primarily those users who have limited authority, ability or resources to obtain information and who rely on financial statements as their principal source of information about an enterprise's activity.

3. An objective of financial statements is to provide information useful to investors and creditors for predicting, comparing and evaluating potential cash flows to them in terms of amount, timing and related uncertainty.
4. An objective of a financial statement for governmental and not-for-profit organizations is to provide information useful for evaluating the effectiveness of the management of resources in achieving the organization's goals that are primarily nonmonetary. Performance measures should be expressed in terms of the not-for-profit organization's goals.
5. An objective of financial statements is to report on those activities of the enterprise affecting society, which can be determined and described or measured and which are important to the enterprise in its social environment.

The author believes that the objectives set by the Trueblood Committee can be compared against the concepts of *enterprise theory*. Under the enterprise theory, business units, most notably listed on national or regional stock exchanges, are viewed as social institutions, composed of capital contributions having "a common purpose and, to a certain extent, roles of common action". Management within this framework essentially maintains an arm's length relationship to owners and has its primary responsibilities (Schroeder *et al* 2009, 503):

1. The distribution of adequate dividends; and
2. The maintenance of friendly terms with employees, consumers, and government units.

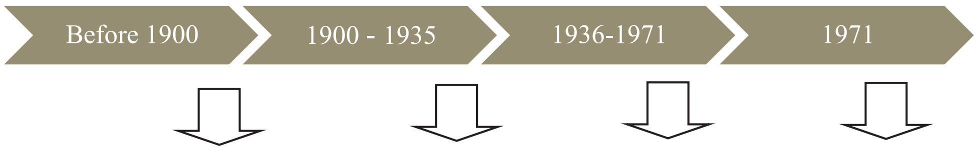
Because this theory applies only to large nationally or regionally traded issues, it is generally considered to have only a minor impact on accounting theory, or the development of accounting principles and practices (Schroeder *et al* 2009, 503).

According to the enterprise theory, accounting may be thought of as a social theory, that is, the firm is considered to be a social institution operated for the benefit of many interested groups (Troberg *et al* 1995). According to Meyer the accounting equation expressing the enterprise theory is (1973, 120) referred through Van Mourik (2010a):

ASSETS = INVESTORS' INPUT CONTRIBUTIONS

From the point of view of all participants, all payments (disbursements of assets) to any participant are distributions of revenue (Meyer, 1973, 120, referred in Van Mourik, 2010a). Although stockholders have legal rights as owners, from the point of view of the enterprise their rights are subsidiary to the organization and its survival (Kam 1990, 315). The responsibility of proper reporting would not only extend to stockholders and creditors, but also many other groups and the general public (Troberg *et al* 1995). In the enterprise or social view, the financial statements are supplemented by a value added statement which would fit in with a country's national accounts. Experiences with value added statements in Germany and the UK in the 1970s showed that in practice the preparation of value added statements suffered from the same problems as other financial statements (Van Mourik 2014, 33). This concept of the firm is, according to Hendriksen (1982, 59) and Schroeder *et al* (2009, 503) most applicable to the large modern corporation that is been obliged to consider the effect of its actions on various groups and on society as a whole. According to the principles prescribed by the Trueblood Committee, these various interest groups may be government agencies, not-for-profit organizations and society.

In Figure 2 the author has summarized the first attempts to define the theoretical basis of accounting on a timescale. The author has included the equity theory in the figure which best describes the respective period and the users from whose point of view the financial statements should be presented.



Prevailing theory	**Proprietary theory**	**Mostly proprietary theory**	**Entity theory**	**Enterprise theory**
Presen-tation of financial statements	Financial information is presented from the proprietor's point of view.	Financial information is presented from the proprietor's point of view. First attempts were made to introduce entity theory.	The function of accounting is to provide quantitative information that is intended to be useful for users in making economic decisions.	The basic objective of financial statements is to provide information on which to base economic decisions.
Users	Owners	Owners	Investors	Investors, creditors, governmental and not-for-profit organizations

Figure 2. First attempts to define the theoretical basis of accounting
Source: composed by author

The objectives enumerated by the Trueblood Committee became the basis for the first release in the FASB's conceptual framework project (Schroeder *et al* 2009, 40), which will be discussed in more detail in the following chapters.

1.3. The Conceptual Framework Developed by the FASB

In 1978, the FASB issued a formal statement of financial reporting objectives – "*Objectives of Financial Reporting by Business Enterprise*", Statement of Financial Accounting Concepts No.1 (SFAC No. 1) (Anthony *et al* 1989, 18), which identified three objectives of financial reporting (Delaney *et al* 2003, 24). The conceptual framework was formed with the intention of providing the backbone for principles-based accounting standards (Nobes, 2005).

The SFAC No. 1 was concentrated on financial reporting rather than on financial statements. Although the terms financial reporting and financial statements are used both in general parlance and in technical or legislative environments, they differ in degrees of precision and meaning. According to the FASB, financial reporting includes not only financial statements but also other means of communicating financial information about an enterprise to its external users. Financial statements on the other hand are also financial reports, but in business and accounting the term financial statement has more of a formal status. Usually financial statements refer to a complete set of general purpose financial statements which include a statement of financial position (balance sheet), a statement of comprehensive income, a statement of changes in equity, a statement of cash flows, and notes, comprising a summary of accounting policies and other explanatory notes. Therefore, one can argue that because the FASB is concentrating on "financial reporting" rather than "financial statements" in its conceptual framework this is an indirect support to the enterprise theory, which takes into account the needs of a wider user group, including employees, government agencies and a wider society.

According to W.R. Scott (1997, 59), the question also arises how historical-cost-based financial reporting as proposed by the FASB can be useful in predicting the future returns. Scott (1997, 59) believes that this is probably the major difficulty that the FASB's conceptual framework faced. But SFAC No. 1 states that "although investment and credit decisions reflect investors' and creditors' expectations about future enterprise performance, those expectations are commonly based at least partly on evaluation of past enterprise performance". This is the crucial argument that past-oriented, historical-cost-based financial statement information is to be useful for investor decision making which the author agrees with.

Users of financial statements are divided into internal and external groups. Internal users include management and directors of the business enterprise. Internal reports tend to provide information that is more detailed than the information available to or used by external users (Delaney *et al* 2003, 24). According to SFAC No. 1 (1978, 13) "potential external users include owners, lenders, suppliers, potential investors, and creditors, employees, customers, financial analysts, tax and regulatory authorities, business researchers, the public etc.". External user's needs are emphasized because these users lack the authority to obtain the financial information they want and need from the enterprise (Delaney *et al* 2003, 24). The author believes that defining so many users of financial reporting gives again support to the enterprise theory as the firm is considered to be a social institution operated for the benefit of many interested groups. On the other hand, when the FASB states that "financial reporting should provide information that is useful to present and potential investors and creditors and other users in making rational investment, credit, and similar decisions" (SFAC No. 1… 16-17), one can argue that in mentioning or singling out investors and creditors among users, the FASB's position cannot be viewed as rendering support for the enterprise theory, but may rather be interpreted as a support for entity theory (Troberg *et al* 1995).

The author would also like to draw attention to the fact that according to the FASB, users should have a reasonable understanding of business and economic activities. This is also stressed by Anthony *et al* (1989, 19), who note that the intended users are expected to have attained a reasonable level of sophistication in using the statements, as these are not prepared for uninformed persons.

"Financial reporting should provide information about how management of an enterprise has discharged its stewardship responsibility to owners (stockholders) for the use of enterprise resources entrusted to it. To the extent that management offers securities of the enterprise to the public, it voluntarily accepts wider responsibilities for accountability to prospective investors and to the public in general. Society may also impose broad or specific responsibilities on enterprises and their managements" (SFAC No. 1… 21). Because it is the owners who reappoint or replace management, the stewardship objective, as stated by the FASB, supports a proprietary theory (Troberg *et al* 1995). On the other hand, viewing "society as imposing constraints on enterprise" further supports a broader view on users, and thereto the enterprise theory.

Although SFAC No. 1 indicates using many equity theories when defining the users or objectives of financial statements (including proprietary, entity and enterprise theory), the author believes that the framework developed by the FASB is somewhere between the enterprise and entity theory. This is supported by the fact that the SFAC No. 1 uses the term "financial reporting" which is broader than financial statements and may also include social responsibility, environmental and other reporting. This indicates that the enterprise is also accountable to wider society (including investors, creditors, governmental and not-for-profit organizations). This is further supported by defining a wide range of potential external users. On the other hand SFAC No. 1 specifies that financial reporting should provide information that is useful to present and potential investors and creditors, which is direct support towards the entity theory. Therefore, one can argue that from the point of view of equity theories the FASB should be more precise when defining the objectives of financial accounting and potential users as the current conceptual framework remains too much in abeyance.

1.4. The Conceptual Framework Developed by the IASB

According to McGregor and Street (2007), in the early 1970s, the FASB had the foresight to begin development of the board's conceptual framework. The resulting model provided a service to standard setters, students, and practitioners. Indeed, the idea was so favourably received that the basic concepts developed in the US were eventually adopted by the then International Accounting Standards Committee (IASC, the precursor to the International Accounting Standards Board) and the world's major English speaking national accounting standard setters. In 1989, IASC released the "*Framework for the Preparation and Presentation of Financial Statements*" (the Framework), which was intended to be the IASB's conceptual foundation upon which later accounting standards would be built. This document identifies the expected beneficiaries of financial reporting, the objective of the reporting process, the key underlying assumptions (going concern etc.), the qualitative characteristics of financial statements (understandability, relevance etc.) and the elements (assets, liabilities, etc.). (Epstein *et al* 2003, 6)

According to the Framework, "the objective of financial statements is to provide information about the financial position, performance and changes in the financial position of an enterprise that is useful for a wide range of users in making economic decisions" (International Accounting Standards Committee 1998, 38). The author would like to emphasize that the Framework is opposite to SFAC No. 1 concentrating on financial statements rather than on financial reporting. This shows that the IASB has taken a narrower approach to financial accounting as a whole.

"The users of financial statements include present and potential investors, employees, lenders, suppliers and other trade creditors, customers, governments and their agencies and the public" (International Accounting Standards Committee 1998, 36). The above can be interpreted to imply that there are no major differences in the information needs between user groups. Furthermore, listing a wide range of users seems to support the enterprise theory, that is, accounting is thought of as a social theory and the firm is considered to be a social institution for the benefit of many interested groups. (Troberg *et al* 1995)

"Financial statements users use these reports in order to satisfy some of their different information needs" (International Accounting Standards Committee 1998, 36). This makes the impression that the needs for information differ among users, at least to some extent, and therefore this statement leaves the observer somewhat puzzled. In discussing the needs of different users, IASC makes the impression that it is really the nature of decisions which differs among users and which in turn may affect the extent of information needed for the decisions. This does not, however, necessarily mean that the nature of information needed differs between the users. Troberg and Ekholm (1995) even argue that information for one type of user is likely to be relevant also for another type of user. In fact, there is only one economic reality of an enterprise at a specific point of time. It is another question that different persons and user groups may view this economic reality differently. (Troberg *et al* 1995)

"Financial statements also show the results of stewardship of management, or the accountability of management for the resources entrusted to it. Those users, who wish to assess the stewardship or accountability of management, do so in order that they make economic decisions; these decisions may include, for example, whether to hold or sell their investment in the enterprise or whether to reappoint or replace the management" (International Accounting Standards Committee 1998, 38). Assuming a non-distress situation, the company acts of most Western industrialized countries provide only the owners with the right to reappoint or replace the management. Therefore, the IASC position can be interpreted as a support for proprietary theory, where the owner or the proprietor acts at the centre of interest (Troberg *et al* 1995).

This view is supported by Van Mourik (2014, 39), who believes that the objective of general purpose financial reporting in proprietary theory is to discharge managers from their stewardship obligations so that proprietors can decide whether or not to continue the venture.

"While all of the information needs of these users cannot be met by financial statements, there are needs which are common to all users. As investors are providers of risk capital to the enterprise, the provision of financial statements that meet their needs will also meet most of the needs of other users of financial statements" (International Accounting Standards Committee 1998, 37). According to the prevailing dominant structure of the balance sheet, the owners and the creditors are the users which have invested capital. This is in line with the entity theory, that is, the business is considered to have a separate existence, even personality of its own, and the founders and owners are not necessarily identified with the existence of the firm. (Troberg *et al* 1995)

Similarly to FASB's SFAC No. 1 the different elements of the IASB's Framework indicate using different equity theories when defining the users or objectives of financial statements. The author believes that the Framework developed by the IASB is most similar to entity theory. Although the framework defines a wider range of financial statement users, it specifies that as investors are providers of risk capital to the enterprise, the provision of financial statements that meet their needs will also meet most of the needs of other users.

In conclusion, the author believes that based on the review of conceptual frameworks of the IASB and the FASB, it is recommended that both organizations have a more explicit and coherent view of the objectives and user groups of financial reporting (FASB) or financial statements (IASB). In their separate conceptual frameworks, too much is left open on what exactly the objectives of financial statements should be and who the users should be. In different sections of the conceptual frameworks, one could define that financial statements should be presented from the owner's point of view (*proprietary theory*), in other sections that they should be drafted from the entity's (*entity theory*) or enterprise (*enterprise theory*) standpoint. Whether the objectives of financial statements and intended users will be better defined in their joint conceptual framework is under investigation in the following chapters.

1.5. The Conceptual Framework Developed Jointly by the IASB and the FASB

Given the globalization of capital markets and international demand for unequivocally accepted standards the IASB and the FASB initiated, in isolation from each other, a discussion about the drafting and presenting of financial reports in 2001. In 2004, the boards found that this treatment should be carried out in coordination to promote the general use of international financial reporting standards. At their joint meeting in October 2004, the IASB and the FASB decided to add to their respective agendas a joint comprehensive project to develop a common conceptual framework, based on and built on both the existing IASB Framework and the FASB SFAC No. 1 that both boards would use as a basis for their accounting standards.

The Conceptual Framework project is conducted in eight phases. The first phase, phase A, was divided into three parts, which will be discussed more thoroughly in the next chapters. The boards began the process of developing the objective of financial reporting by reviewing their own frameworks and concepts first – the SFAC No. 1 (FASB) and the Framework (IASB). In July 2006, the IASB and the FASB published a Discussion Paper (DP) of the Conceptual Framework for public comment. In its re-deliberations of the issues, the IASB and the FASB considered all of the comments received and information gained from outreach initiatives and in May 2008, they jointly published an Exposure Draft (ED). Finally, the boards reconsidered all of the issues mentioned in the comments received and a result of those reconsiderations the IASB published "*Conceptual Framework for Financial Reporting 2010*" and the FASB published "*Statement of Financial Accounting Concepts No. 8*" (hereinafter the Developed Standard or DS).

The following chapters examine the above-mentioned three documents – DP, ED and DS – from the point of view of primary user groups and their information needs (e.g. objectives of the financial statements) and other characteristics by relating those to different equity theories. The work will be concluded with a summary comparison of the three documents drafted in phase A of the joint project – Discussion Paper, Exposure Draft and Developed Standard.

1.5.1. Discussion Paper

According to the Discussion Paper (DP), "the objective of general purpose external financial reporting is to provide information that is useful to present and potential investors and creditors and others in making investment, credit, and similar resource allocation decisions" (Financial Accounting Standards Board, 2006, July 6). According to Lennard (2007), it is worth mentioning that the DP focuses on financial reporting (the focus of FASB's SFAC No. 1) rather than financial statements (the focus of IASB's Framework). This wider focus means that its prescriptions apply at least potentially to, for example, forecasts and environmental and social information. Including this kind of information in the financial statements means that the company is taking the responsibility to a wide group of users (society). In the opinion of the author, this implies to the *enterprise theory*.

To help achieve its objective, "financial reporting should provide information to help present and potential investors and creditors and others to assess the amounts, timing, and uncertainty of the entity's future cash inflows and outflows (the entity's future cash flows). That information is essential in assessing an entity's ability to generate net cash inflows and thus, to provide returns to investors and creditors" (Financial Accounting Standards Board, 2006, July 6). When looking at the objective of financial reporting, this is most similar to *residual equity theory*, which is not an equity theory in this sense as it is not directly based on a normative perspective on the justification of private property rights. It is based on Staubus's decision-usefulness theory. The normative assumption here is that the primary role of financial reporting is to enable investors to make resource allocation decisions (Van Mourik 2014, 22). Lennard (2007) believes that the exclusive focus on a decision-usefulness objective has led to an excessive emphasis on the forecasting of future cash flows, and insufficient emphasis on reliability, which seems to be an essential qualitative characteristic of financial statements.

"The objective of financial reporting stems largely from the needs and interests of users. Potential users of financial reports and their information needs include: equity investors, creditors, suppliers, employees, customers, governments and their agencies and regulatory bodies and members of the public" (FASB, July 6, 2006). As used in the DP, the term investors refers to "equity investors and includes present and potential holders of equity securities, holders of partnership interests, and other owners; as well as their advisers" (FASB, July 6, 2006). The term "creditors" used in the DP includes "present and potential institutional and individual lenders and their advisers" (FASB, July 6, 2006). When looking at the users from the viewpoint of equity theory, the author believes that focusing on investors and creditors rather takes the position towards *entity theory* or even *residual equity theory*. "Suppliers, employees, customers, governmental agencies, or others also often have claims to cash payments by the entity. However, claims by such parties are not included in the category 'creditors' because those parties have dual roles in relation to an entity. For instance, a customer's right to receive goods or services may be more important to them than any right to receive a cash refund or other cash payment" (FASB, July 6, 2006). Although implication is made to a wider group of users, this does refer to the enterprise theory, as the DP states that "information that satisfies the needs of investors and creditors is likely to be useful to those parties as well" (FASB, July 6, 2006), which clearly puts investors and creditors to the first place. In the author's opinion, the DP contains some of the IASB and FASB's original ideas. For example, the DP "borrowed" a detailed description of the users of the financial statements according to the IASB's framework. However, the new document is supplemented by the definition of terms "investor" and "creditor".

"Management and the governing board of an entity are also interested in the entity's ability to generate net cash inflows because that is a significant part of management's responsibility and accountability to the entity's owners" (FASB, July 6, 2006). In the author's opinion, describing the management stewardship obligation to owners may at first sight give implication to the proprietary theory, but is stating that "management is responsible for preparing financial reports, but not their intended recipient. In addition, management is able to prescribe the form and content of the information it needs in satisfying its responsibility to owners" (FASB, July 6, 2006) suggests that the purpose of accounting and financial statements is not to assess the wealth of the owners (proprietary theory), but rather to give information to other users.

The information provided by general purpose external financial reporting is directed to the needs of a wide range of users rather than only to the needs of a single group (owners). Accordingly, "financial reports reflect the perspective of the entity rather than only the perspective of the entity's owners (the existing ordinary shareholders or ordinary shareholders of the parent entity in consolidated financial statements) or any other single group of users. However, adopting the entity perspective as the basic perspective underlying financial reporting does not preclude including information that is primarily directed to the entity's owners or to another group of users in financial reports either. For example, financial reports include earnings per share, which may be of interest largely to holders and potential purchasers of those shares. However, this information is in addition to and not a replacement of, information prepared in accordance with the entity perspective" (FASB, July 6, 2006).

Therefore, the most interesting aspect about the DP is that the IASB and the FASB are trying to justify financial reporting from a theoretical point of view and by using *entity perspective* (theory). Using specifically the entity perspective has raised many concerns. When faced with a transaction, should the accountant ask how this transaction affects the entity or how it affects the owners' equity of the entity? This is a particularly important decision for the boards, because adopting either the entity or proprietary or other perspective of accounting will influence several controversial accounting issues, such as accounting for stock options, distinguishing equity from liabilities in cases of instruments that carry some characteristics of both (such as convertible bonds), and using the parent-company or economic-unit concept in preparing consolidated financial statements. In the DP, the boards expressed a preference for the entity perspective. However, the DP does not provide clear rationale for this conclusion. Furthermore, in a nation where wealth is protected through property rights, it seems inconsistent to base financial reporting on the entity concept, which is silent regarding the division of property rights between the various stakeholders (i.e., management, creditors, and owners) of an enterprise. (Gore and Zimmermann, 2007)

1.5.2. Exposure Draft

According to the Exposure Draft (ED), "the objective of general purpose financial reporting is to provide financial information about the reporting entity that is useful to present and potential equity investors, lenders and other creditors in making decisions in their capacity as capital providers. Information that is decision-useful to capital providers may also be useful to other users of financial reporting who are not capital providers" (Exposure Draft: Conceptual…14). To accomplish the objective "financial reports should communicate information about an entity's economic resources, claims on those resources, and the transactions and other events and circumstances that change them. The degree to which that financial information is useful will depend on its qualitative characteristics" (FASB, May 29, 2008). The objective or the focus of financial reporting is again in "allocating resources" that is an implication to *residual equity theory*.

"The information provided by general purpose financial reporting focuses on the needs of all capital providers (those with a claim on the entity's resources), not just the needs of a particular group. Financial reports reflect the perspective of the entity rather than the perspective of the entity's equity investors, a particular group of its equity investors or any other group of capital providers. Adopting the entity perspective does not preclude the inclusion of additional information that is primarily directed to the needs of an entity's equity investors or to another group of capital providers in financial reports. For example, financial reports often include quantitative measures such as earnings per share, which may be of particular interest to holders and potential purchasers of those shares" (FASB, May 29, 2008). Based on that it can be concluded that in the ED, the boards continue to justify the use of *entity theory*, although they admit that some parts or more precisely ratios of the financial reports may indicate concentration on owner's or proprietors and therefore may indicate the use of proprietary theory.

"The primary user group includes both present and potential equity investors, lenders and other creditors, regardless of how they obtained, or will obtain, their interests" (FASB, May 29, 2008). In the ED, the terms "capital providers" and "claimants" are used interchangeably to refer to the primary user group (FASB, May 29, 2008). The author believes that this is again a broad definition of primary user groups as, one can review employees and government agencies (i.e. tax authorities) under other creditors who have obtained interest in the company. But referring to such a wide range of users gives implications to the *enterprise theory* rather than the entity theory.

"Capital providers are interested in financial reporting because it provides information that is useful for making decisions. The decisions that capital providers make include: whether and how to allocate their resources to a particular entity (i.e. whether and how to provide capital), and whether and how to protect or enhance their investments. When making those decisions, capital providers are interested in assessing the entity's ability to generate net cash inflows and management's ability to protect and enhance the capital providers' investments" (FASB, May 29, 2008). Distinguishing "capital providers" from other primary users and referring to "decision-making" and "allocating resources" indicates support to *residual equity theory*. The definition of useful information has almost remained the same compared to the DP. "Information is useful for the capital providers, when it helps to assess cash-flow prospects and management stewardship" (FASB, May 29, 2008).

When comparing the DP with the ED, it may be noted that the definition of the users of the financial statements has been changed. If the financial statements were originally directed to "investors" and "creditors", then now the emphasis is on "provider of capital". The author believes that by using the term "provider of capital" the boards are trying to say that it does not matter whether the capital is coming from external or internal resources as these are reviewed as equals, and this is an argument that supports again the entity concept.

The role of management in the ED has remained similar to that in the DP. "Managers and the governing board of an entity (herein collectively referred to as management) are also interested in financial information about the entity. However, management's primary relationship with the entity is not that of a capital provider. Management is responsible for preparing financial reports; management is not their intended recipient. Other users who have specialised needs, such as suppliers, customers and employees (when not acting as capital providers), as well as governments and their agencies and members of the public, may also find useful the information that meets the needs of capital providers; however, financial reporting is not primarily directed to these other groups because capital providers have more direct and immediate needs" (FASB, May 29, 2008).

To conclude, the ED stresses that "an entity's financial reporting should be prepared from the perspective of the entity (entity perspective) rather than the perspective of its owners or a particular class of owners (proprietary perspective)" (FASB, May 29, 2008) and therefore, the board's continue to base the conceptual framework based on the entity theory, although the definition of different elements (i.e. purpose of financial reporting, users etc.) are conflicting by referring to different equity theories.

1.5.3. Developed Standard

In September 2010, the IASB issued its revised "*Conceptual Framework for Financial Reporting 2010*" (the Conceptual Framework) and FASB issued the "*Statement of Financial Accounting Concepts No. 8*" (SFAC No. 8). The IASB's Conceptual Framework consists of four chapters. The FASB's SFAC No. 8 had only Chapters 1 and 3 and it replaced FASB's SFAC No. 1 and SFAC No. 2.

Chapter 1 on "The objective of general purpose financial reporting" and Chapter 3 on "The qualitative characteristics of useful financial reporting information" are both the result of a joint project of the IASB and the FASB. Chapter 1 no longer refers to either the entity or the proprietary perspective. Chapter 2 on the reporting entity does not yet have any content but the IASB and the FASB did issue a joint Exposure Draft (ED) on 16 July 2010. Chapter 4 of the IASB's Conceptual Framework is the remaining text of the 1989 IASC Framework on the definition, recognition and measurement of the elements of financial statements. On 18 July 2013, the IASB issued a Discussion Paper to revise Chapter 4 of its 2010 Conceptual Framework. This was not part of a joint project with the FASB.

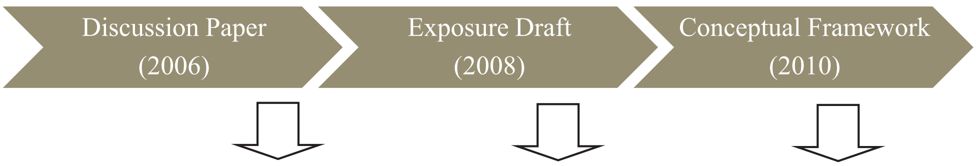
"The objective of general purpose financial reporting is to provide financial information about the reporting entity that is useful to existing and potential investors, lenders, and other creditors in making decisions about providing resources to the entity. Those decisions involve buying, selling, or holding equity and debt instruments and providing or settling loans and other forms of credit" (SFAC No.8… 1). The objective of financial reporting is again on "useful decisions" that is an implication to the residual equity theory. Proprietary, entity and enterprise theory have little to say about the scope of the reporting entity that would still be of use today (Van Mourik 2014, 29). According to Pounder (2010) the new converged objective ("general purpose financial reporting") differs most from each board's previous objective. Both boards view their standards setting efforts as directed at the needs of financial-statement users who are not in a position to obtain specific information tailored to their individual needs.

The first thing about the logic that governs the definition of financial statement elements is the question which financial statement elements to define. A framework based on proprietary theory would focus on the recognition and measurement of assets and liabilities. The recognition and measurement of revenues and expenses would simply be a consequence of measurable changes in the values of assets and liabilities, and performance would be measured on an all-inclusive or comprehensive income basis. A framework based on entity theory would focus on the measurement of operating performance and regard the statement of financial position as secondary to the statement of financial performance (Van Mourik 2014, 32). In the joint Developed Standard (DS) no definitions of assets, liabilities, equity, revenue, expenses etc. has been provided. The Chapter 4 of the IASB's Conceptual Framework contains these elements of financial statements, but those are copied from the 1989 Framework. The definitions provided are clearly focused on defining assets and liabilities first and using these terms to define income and expense. With that one can argue that the IASB's Conceptual Framework is oriented on *proprietary theory*.

When looking at the DS from the user's perspective using the equity theories, the DS states that "many existing and potential investors, lenders, and other creditors cannot require reporting entities to provide information directly to them and must rely on general purpose financial reports. Consequently, they are the primary users to whom general purpose financial reports are directed" (SFAC No.8… 2). It is difficult to determine, which users are meant under "other creditors" – are these employees and suppliers as defined in the DP and ED? It is hard to say, but paragraph OB10 of SFAC No.8 clearly states that "regulators and members of the public other than investors, lenders, and other creditors may find information in general purpose financial reports useful, but those are not the parties to whom general purpose financial reports are primarily directed". With that statement the DS eliminates association to the enterprise from the user's perspective.

"Existing and potential investors, lenders, and other creditors need information to help them assess the prospects for future net cash inflows to an entity. To assess an entity's prospects for future net cash inflows, they need information about the resources of the entity, claims against the entity, and how efficiently and effectively the entity's management and governing board have discharged their responsibilities to use the entity's resources. Examples of such responsibilities include protecting the entity's resources from unfavourable effects of economic factors such as price and technological changes and ensuring that the entity complies with applicable laws, regulations, and contractual provisions. Information about management's discharge of its responsibilities also is useful for decisions by existing investors, lenders, and other creditors who have the right to vote on or otherwise influence management's actions" (SFAC No.8… 2)

In SFAC No.8 “Basis for Conclusion for Chapter 1” the FASB states that “Over time, the separation between businesses and their owners has grown. The vast majority of today’s businesses have legal substance separate from their owners by virtue of their legal form of organization, numerous investors with limited legal liability, and professional managers separate from the owners. Consequently, the boards concluded that financial reports should reflect that separation by accounting for the entity (and its economic resources and claims) rather than its primary users and their interests in the reporting entity” (SFAC No.8… 7). Based on this it can be stated that the IASB and the FASB have continued to promote the entity concept rather than the views of proprietors.



Primary users	Investors and creditors	Capital providers and claimants	Existing and potential investors, lenders, and other creditors
Presentation of financial statements	Financial reporting should be prepared from the perspective of the entity (entity theory)	Financial reporting should be prepared from the perspective of the entity (entity theory)	Financial reporting should be prepared from the perspective of the entity (entity theory) Financial statements are not directed to regulators and members of the public

Figure 3. Comparison of Discussion Paper, Exposure Draft and final version of Conceptual Framework
Source: composed by the author

When comparing the final result, the jointly developed conceptual framework with DP and ED (see Figure 3), it can be said that the definition of users has changed the most over time. Both the DP and the ED proposed identifying a group of primary users of financial reports, but in the DP, the terms investors and creditors were used. On the other hand, the ED used the terms capital providers and claimants. In the final version, existing and potential investors, lenders, and other creditors are seen as primary users. Some respondents to the ED said that other users, who have not provided and are not considering providing resources to the entity, use financial reports for a variety of reasons. The board sympathized with their information needs but concluded that “without a defined group of primary users, the Framework would risk becoming unduly abstract or vague” (SFAC No.8… 9). The author believes that the definition of primary users (existing and potential investors, lenders, and other creditors) is still vague in the DS, because the DP gave a more comprehensive overview of different user groups and their needs, when the DS remains quite laconic.

When defining "financial report" and "financial reporting", the DS currently equates these terms with General Purpose Financial Reports (GPFRs). Within the standards themselves, "GPFRs" and "general purpose financial statements" are treated as synonyms. International Accounting Standard (IAS) 1 specifies the components of such statements to be presented (i.e. statement of financial position, income statement, changes in equity, cash flows, and notes). Broadly, "financial reporting can be said to be the periodic process of providing information in financial statements (including the notes thereto) about the financial position and performance of a reporting entity to parties (users) external to that entity to assist them in making informed decisions about allocating scarce resources" (Australian Government Financial Reporting Council, 2012).

When comparing the jointly developed conceptual framework with the individual frameworks published by the FASB in 1978 and by the IASB in 1989 it can be said that the final version of jointly developed conceptual framework has been influenced by both of the earlier papers and some significant changes have been made compared to the first versions. For example, paragraph 10 of the Conceptual Framework of IASB (1989) stated that "as investors are providers of risk capital to the entity, the provision of financial statements that meet their needs will also meet most of the needs of other users that financial statements can satisfy," which might have been read to narrow the focus to investors only. However, paragraph 12 of the same document explicitly stated that the objective of financial statements is to provide information "that is useful to a wide range of users in making economic decisions." Thus, the IASB's Conceptual Framework of 1989 focused on investors' needs as representative of the needs of a wide range of users but did not explicitly identify a group of primary users. The DP and the ED proposed identifying a group of primary users of financial reports, which was also done in the issued jointly developed conceptual framework. Also, the focus has gone from "making-decisions" to "making decisions in respect of giving resources" which can be interpreted as a support to the residual equity perspective because reference to "decisions" and "resources" clearly states the importance of investors (both equity and debt capital).

Thus it can be argued that the earlier frameworks developed by the IASB and the FASB were more vague in respect of from whose standpoint (e.g. equity theory) the financial statements should be presented. When analysing the earlier work, one could state that the IASB's Conceptual Framework presents the entity theory and the FASB's Statement of Financial Accounting Concepts No.1 was torn between entity and enterprise theory. In the DS, both boards have agreed to follow the principles of entity theory (although not as clearly stated as in DP and ED) and they have gone even as far to exclude proprietary theory from having a chance to be the basis for entity's financial reporting. This is due to the fact that the majority of today's businesses have substance distinct from that of their capital providers (Kaminski *et al* 2011).

Van Mourik (2010a) argues that the IASB/FASB's interpretation of the the entity perspective is somewhere between entity and proprietary theory – the equity theory[1]. Van Mourik (2010a) believes that not choosing between the two views of the firm and consequently not choosing between the two approaches to income determination (revenue-expense or asset-liability) will lead to inconsistencies in accounting standards. Ohlson *et al* 2010 are of the opinion of that it is far from clear whether, in fact, creditors prefer an entity perspective in financial reporting as they are not aware that such a case has ever been made. Indeed, clear identification of the property rights (claims) of common shareholders also delineates claims by others, including minority interests. Hence, the principle should be adopted if one accepts that equity markets are the main users of financial reports and the proprietorship theory of accounting provides for a more coherent perspective than the entity theory (Ohlson *et al* 2010).

To conclude, decision-usefulness theory arguably forms the basis of the decision-usefulness objective in the FASB's and IASB's jointly developed conceptual framework. The definition of the financial statement elements and the asset-liability approach to the determination of (comprehensive) income in the FASB and IASB frameworks show a proprietary perspective (Van Mourik 2014, 34). It is therefore ironic that in the 2008 Exposure Draft both boards claimed that the entity perspective was the appropriate basis for the Framework and hence, developing accounting standards.

According to Lee (2009, 156) in the history of financial accounting theory the relative emphasis has changed from a proprietary perspective concentrating on the financial position of owners to an entity perspective focusing on income or earnings. The most explicit theoretical switch has been to the user of financial statements, i.e. consumer-orientated financial accounting theory highlighting information needs in decision situations. But the practical means of satisfying these needs has not changed over the years and the theory of satisfying users' needs remains a relatively empty one when little is known about these needs in practice (Lee 2009, 156). Declaring decision usefulness (i.e. implying to residual equity theory) as the primary reporting objective is a hollow gesture in such circumstances. Therefore, the author believes that further analysis is needed about the users and uses of general-purpose financial reports by also taking into account the size of the company.

1.6. The Current Estonian Accounting Legislation from the Viewpoint of Equity Theories

Based on the previously mentioned issues, the following research question has been developed – to what extent has Estonian accounting legislation provided discussions about equity theories? This research aims at developing a stronger basis to formulate a comprehensive Estonian accounting framework, including a more consistent use of the accounting point of view, in order to construct Estonian accounting standards. In

[1] For more information about equity theory see Chapter 1.2.

this section, an overview of the Estonian Commercial Code (effective from July 1, 2014) (ECC), Accounting Act (effective from March 23, 2014) (EAA) and Accounting Standards Board Guidelines (ASBGs) are provided to describe the nature and practices of Estonian financial reporting and enable comparison with equity theories.

In general, neither of the above mentioned laws or regulations mention any equity theories. Therefore, a further analysis is needed taking into account the main characteristics of different equity theories, e.g. company form, principal financial statement, the basis for determining profit or loss, how revenues, expenses, assets and liabilities are measured, what the basis for consolidation is, and how minority interest is recognised. The analysis is limited to some characteristics of equity theories as Estonia has an open market economy and therefore, many institutions and organisations influence the development and drafting of the Estonian accounting legislation, which is further discussed in Chapter 2. Our accounting standards are mainly influenced by the IFRSs developed by the IASB for which a more thorough analysis of relations between equity theories and those documents has already been done in the previous chapters. Also, accounting directives developed by the European Commission influence the Estonian accounting law and these are more thoroughly analysed in Chapter 2 using institutional theories.

According to the ECC, the following classification of companies may operate in Estonia: general partnership, limited partnership, private limited company, public limited company or branch. Also, any natural person may be a sole proprietor. According to the proprietary theory, a suitable form of company is a general or limited partnership and a sole proprietor. According to the entity theory, a suitable form of company is a public limited company.

According to the EAA § 16, one of the basic principles forming part of the internationally accepted accounting and reporting principles shall be taken into consideration in preparation of annual accounts – the business entity principle. According to that the accounting entity keeps separate accounts of its assets, liabilities and business transactions and the assets, liabilities and business transactions of its owners, creditors, employees, customers and other persons. Under this principle, the company is separated from the owners and is operating as an independent organism. This is an indication to the entity theory ("separate accounts of others") or even to the enterprise concept when we take into account actors influencing the activities of the company – "owners, creditors, employees, customers and other persons".

According to Estonian ASBG No. 1 Section 5 "the objective of the financial statements is to present a true and fair view of the financial position, financial performance and cash flows of the accounting entity". As the Estonian Accounting Standards Board Guidelines are based on the IFRS for SME's since January 1, 2013 (previously they were based on the "big" IFRS), the objective of financial statements is also somewhat different compared to the IASB's Conceptual Framework. The latter was oriented to "general purpose financial reporting", "useful information" and “making decisions about providing resources to the entity”, but in the Estonian standards the focus is narrower concentrating on specific financial statements. According to Van Mourik (2014, 39) in the proprietary theory, “the objective of general purpose financial reporting is to discharge managers from their stewardship obligations so that proprietors can decide whether or not to continue the venture”, and in the entity theory, “the objective of general purpose financial reporting is to enable managers to reconcile the different stakeholders’ conflicting interests so the entity can survive and thrive”. In the author’s opinion the objective described in the Estonian standards is too vague to draw any parallels with equity theories. The accentuation on “financial position” (i.e. the balance sheet) gives implications to the proprietary theory, but at the same time “financial performance” indicates the income statement that is inherent to the entity theory.

The Estonian legislation does not highlight nor prefer any principal financial statement. The EAA § 15 states that the annual accounts comprise the main statements (balance sheet, income statement, cash flow statement and statement of changes in owners' equity) and notes to the accounts. Therefore, nothing can be concluded on the influence of the equity theories.

When looking at the basis for determining profit or loss, both EAA § 3 and Estonian ASBG No. 1 Section 31 state that “profit (loss) is the difference between the income and expenses of an accounting entity during an accounting period”. Therefore, the basis for determining profit or loss follows the income-expense principle inherent in the entity theory. This is similar to the IASB’s *Conceptual Framework* where measurement of profit is directly related to income and expenses. The recognition and measurement of income and expenses, and hence profit, depends in part on the concepts of capital and capital maintenance used by the entity in preparing its financial statements.

According to Estonian Accounting Standards Board Guideline No. 1 Section 39[2] “Financial statements are prepared to inform a wide range of users of these statements – including the entity’s owners and creditors, employees, business partners, the general public, state institutions and others”. With that statement, the guidelines take the enterprise approach for defining financial statement users when including “employees, the general public and state institutions” which is a broader range of users compared to the entity theory.

Estonian ASBG No. 1 Section 39 also states that “In preparing the financial statements, it should be kept in mind that they should be easily legible and understandable to external users who may not be familiar with the day-to-day activities of the entity”. The mentioned “external users” gives implications to the entity concept.

[2] The author has used the English versions of the ASBGs.

When looking at the definitions of income and expenses, the ASBG No. 1 Sections 24-25 state that:

> "(a) Income is inflows (increase in economic benefits) during the accounting period that result in increases in assets or decreases in liabilities and that increase the equity of an accounting entity, other than contributions made by owners to the equity"
> (b) Expenses are outflows during the accounting period (decrease in economic benefits), that result in decreases of assets or increases in liabilities and that decrease the equity of the accounting entity, other than distributions made to owners from the equity."

IASB's *Conceptual Framework* 4.25 defines income and expenses as follows:

> "(a) Income is increases in economic benefits during the accounting period in the form of inflows or enhancements in assets or decreases of liabilities that result in increases in equity, other than those relating to contributions from equity participants.
> (b) Expenses are decreases in economic benefits during the accounting period in the form of outflows or depletions of assets or incurrences of liabilities that result in decreases in equity, other than those relating to distributions to equity participants."

When comparing the Estonian Accounting Standard Board's (EASB) income-expense definitions with the IASB's definitions, one can say that they are similar. As concluded in Section 1.4.3, the IASB's definition of assets and liabilities and thereto equity, income and expenses follows the logic of the proprietary theory and therefore, the Estonian accounting standards take the same direction.

When looking at Estonian Accounting Standards Board Guideline No. 11, which explains accounting for business combinations, subsidiaries and associates, this standard requires that in the consolidated financial statements all subsidiaries controlled by the group shall be consolidated line by line (i.e. not proportionally). Non-controlling interest shall be included as share of equity in the consolidated balance sheet, separately from the equity of the parent entity's owners. Consolidated financial statements include among other things the separate balance sheet, income statement, cash flow statement, and statement of changes in equity of the parent entity. With that the standard implies to the entity perspective, which also requires full consolidation showing minority interest under equity and disclosure of both unconsolidated and consolidated financial statements (Van Mourik 2014, 39).

To conclude, as the Estonian accounting legislation is heavily influenced by the international financial reporting standards developed by the IASB, it is as difficult to point out which equity theory they follow as different elements (i.e. the basis for determining profit or loss, how revenues, expenses, assets and liabilities are measured, what the basis for consolidation is and how minority interest is recognised) give implications to different equity theories. Therefore, one can conclude that the Estonian accounting legislation does not follow any specific equity theory.

1.7. Concluding Remarks on the Possibility of Using Equity Theories as a Basis for an Accounting Framework

The historical overview of the equity theories has taught us different perspectives to the question whose point of view should be taken in the accounting process of companies. According to Van Mourik (2010b), proprietary theory developed to defend the justification of the private property rights of shareholders as owners of the company. Entity theory developed in answer to the recognition that shareholders of a publicly held company own the shares but not the company itself. Enterprise theory developed from the understanding that large publicly held companies are institutions in their own right, the managers of which ought to be responsible and accountable to all stakeholders including society at large. In other words, the entity view and the social view of the corporation are accounting theoretical expressions of the idea that the traditional economic justifications of private property rights have limited validity in case of a publicly held company. (Van Mourik 2010b)

So why did we forget about equity theories and fail to realise their importance to accounting theory, practice and regulation? According to Van Mourik (2010b) firstly, in the 1970s, the distinction between positive and normative accounting came to be made, and people had grown impatient with the lack of rigour in many normative accounting writings. Positive accounting theory was not concerned with a comprehensive theory of accounting as empirical studies are by nature limited to smaller questions. Secondly, the piece-meal approach to regulation within national boundaries fostered a piece-meal approach to establishing and studying accounting standards and their consequences. Thirdly, although many people do recognise the problems associated with the separation of ownership and control, they do not see this as in any way diminishing the justification for the private property rights attached to shareholdings in publicly held corporations as corporate governance mechanisms have been devised to address this problem. Fourthly, since the late 1970s, the political climate in the most powerful western countries has steadily inclined towards deregulation, privatisation and laissez-faire. (Van Mourik, 2010b)

Some authors believe that equity theories may provide a frame of reference for the objectives of the financial reporting, and thereto presentation and measurement of information reported in the financial statements. Still, a comprehensive theory of financial accounting and reporting that would place the different views and disclosure formats into one single framework seems to be impossible to achieve as shown through the analysis of the conceptual frameworks of the IASB and the FASB. According to Van Mourik (2010b), an accounting theory should explain what the social, economic, legal and behavioural assumptions are behind the different income determination models, measurement and valuation paradigms, as well as the financial statement formats and other means of disclosure. It would clarify the place of financial accounting and reporting as a social science and give a foundation for the debate on the purpose of financial accounting and reporting regulation. However, it would never be “one size fits all theory”. (Van Mourik, 2010b)

When taking into account the short accounting history of Estonia and limited research about it, it is clear that there are currently not enough resources available in Estonia to develop a comprehensive theory in accounting that would be the basis for accounting legislation further on. Also, as analysed more thoroughly in the following chapter, there are many institutions affecting the development of the Estonian accounting framework. Therefore, the initiative for a comprehensive accounting framework should become from those international players. The best option for Estonia would be to analyse the local users and uses of financial statement taking into account the local context, for example, a large proportion of SMEs when compiling Estonian good accounting practice. Users’ preferences for example to use the balance sheet or income statement when analysing the financial statements of other SMEs may help to determine from which equity theory point of view they would like the standards to be developed. Still, we have to bear in mind that when we try to create rules or standards appropriate in the Estonian context, we need to juggle between the loopholes available in the European accounting directives as the European Union is an important institution affecting our national legislation.

2. INSTITUTIONAL PRESSURES AFFECTING THE DEVELOPMENT OF A FINANCIAL ACCOUNTING FRAMEWORK IN ESTONIA

A financial accounting framework is like a constitution: It is “a coherent system of interrelated objectives and fundamentals that can lead to consistent standards and that prescribes the nature, function, and limits of financial accounting and financial statements” (Booth 2003, 310). Financial statements represent accounting practises used in companies. The formats of financial statements developed during last century have to provide information for decision making purposes (decision usefulness). To provide information to decision makers, companies prepare general-purpose financial statements. These statements provide the most useful information possible at the least cost. Information included must have qualitative characteristics of accounting information for decision-making purposes. Globalization and transnational business expansion have resulted in a greater need for common rules so that the financial statements of organizations in different countries would be prepared on a similar basis and there would be no possibilities for interpretation.

In the context of accounting Estonia is one of the less-known states in Europe. Until the beginning of the 20th century, there is very little information about accounting in Estonia. This is quite apparent considering that there is practically no accounting-related academic literature even at the local level in the Estonian language. Few authors publishing about Estonian accounting issues include J. Alver and L. Alver (1998, 2001, 2009), Haldma (2001, 2003, 2006), Tikk (2010) and Bailey (1995, 1998).

The Estonian accounting regulation has only a relatively brief history compared to those of some other European countries. One reason was the constant changing of conquerors, all of whom exerted influence on Estonian history in every respect, including accounting. The October Revolution of 1917 gave Estonia the opportunity for freedom and the Republic of Estonia was proclaimed on February 24, 1918. The first period of independence lasted 22 years. Estonia underwent a number of economic, social, and political reforms necessary to come to terms with its new status as a sovereign state. During 1918–1940 the czarist *Russian Commercial Code* regulated all areas of business activities in the independent Republic of Estonia, including accounting and taxation. This Law had been in force since 1834. The Code established the classification of enterprises, the books of accounting records, which each enterprise had to keep and the general accounting requirements. According to the Code all enterprises were classified as big, medium, and small. The number of obligatory books were established and named by the Code. The Code also described how to document and record business transactions, how to make corrections, and retain the books. Correct keeping of accounting records (books) was very important. The main shortcomings of the Russian Commercial Code were as following. Due to its longevity the Code was outdated. The bookkeeping requirements were set up for trading companies, but not for industrial enterprises. Many of the obligatory accounting books mentioned in the Code were not used in the real life. The most important law from this period (in force from January 1, 1926) was indisputably the Law of Golden Balances establishing the valuation principles for securities, inventories and tangible fixed assets. The second law in force from 1935 was the Law of Language for Business Enterprises. From 1935 it became obligatory to keep books in the Estonian language only. Unfortunately, the prepared Bill of the Law of Accounting was not enacted during the first Republic of Estonia.

The independence was lost after incorporating Estonia into the USSR (Soviet Union) in 1940, and in fact after World War II, the Soviet system of bookkeeping was in use. From 1945 until 1990 the Soviet influence on accounting development was obvious, because Estonia was a part of the USSR and accounting in Estonia was a part of the Soviet accounting system.

Estonia regained independence in 1991 after the collapse of the USSR. The transition from command economy to market economy had a huge impact on a great number of aspects in business society, and thus also on accounting. The old bookkeeping system with detailed rules serving the primary task of controlling that the national economic plans were fulfilled was replaced by an accounting system with the primary task of preparing financial reports to the market, but also to give information to management for decision making.

Nations all around the world are following the fast pace convergence of national GAAP with that of the IFRSs. This convergence is mostly influenced by globalization as countries worldwide have been striving for the same purposes – to increase their economic growth and to improve the welfare of their residents. These aims are mainly pursued by developing countries, including Estonia. To achieve these aims, Estonia has opened its market to multinational corporations, has joined the international economic associations and developed a more transparent approach in its accounting principles to adapt to the demands of international financial markets. To accomplish this Estonia has adjusted its generally accepted accounting principles to IFRSs. Some authors, for example Fontes, Rodrigues and Craig (2005) in Portugal, Al-Omari (2010) in Jordan and Irvine (2008) in the United Arab Emirates (the UAE), have also noted that countries around the world are converging their national standards with that of the IFRSs. But the post-IFRS experience of emerging economies has been diverse. According to N. Albu and C. N. Albu (2012), some implementations have reportedly been relatively successful (see, for example, Peng & van der Laan Smith, 2010 in the case of China; Boolaky, 2010 for Mauritius; and Chamisa, 2000, for Zimbabwe) but others have been less so because of non-compliance with the standards, or have even ended in failure (see, for example, Mir & Rahaman, 2005 with regard to Kuwait and Pakistan).

One can argue that globalization is one of the lead factors affecting countries worldwide to adopt IFRSs, especially developing countries. Globalization has been defined by Granell (2000) as “a worldwide pressure to change”, by Stiglitz (2001) as the “closer integration of the countries and peoples of the world” and is also interpreted by Irvine (2008) as “a universal process of institutionalization that both relies on and results in greater interdependence between economies, political systems, culture and societies”. As globalization has been considered one of the many factors that have had a considerable influence on many countries worldwide to adopt IFRSs, then according to prior studies, (Barbu & Baker, 2010; Al-Omari, 2010), some can perceive the convergence of IFRSs as the development of a new worldwide institution, which has achieved great legitimacy among developing countries and also at the international level.

The purpose of this Chapter is to address how globalization and IFRSs have affected the development of financial accounting and reporting in Estonia. This is interpreted through institutional theory. Although using institutional theory to interpret factors affecting the development of the financial reporting framework is not new, its application is underexplored in the context of post-Soviet countries such as Estonia. Therefore, in the literature review the author of the thesis gives an overview of the theoretical framework taking into account the prior papers published that have used institutional theory in their research for defining pressures affecting the development of a financial reporting model. The discussion part is presented in three sub-sections, divided between coercive, normative and mimetic institutional pressures. This is followed by the concluding remarks. This Chapter potentially contributes to the evidence of accounting reforms in emerging economies, their progresses and obstacles. This analysis is important to understand pressures affecting the development of financial reporting systems in emerging countries such as Estonia and take the possible influences into account when developing a new accounting legislation in the future. Therefore, the possible future directions regarding accounting in Estonia are discussed briefly using also institutional theory.

The author has analysed the coercive institutional pressure based on the Estonian accounting legislation from 1990 to 2012 and has divided the integration of the Estonian financial accounting and reporting system into the international framework into three stages using Haldma’s (2003) classification: (1) introductory stage (1990-1994), (2) system building stage (1995-2002), and (3) system improving stage (since 2003). After that, the author has focused on the analysis of normative institutional pressure taking into account the impact that the Big 4 auditing companies have in the Estonian context. Finally, the author gives an overview of mimetic institutional pressures affecting the accounting and reporting system in Estonia. As a methodological technique the literature review and document analysis are used in all the three subsections. For collecting examples and reactions to the changes in Estonia in light of the three institutional pressures, among other things the master theses and papers written by Estonian researchers have been used.

2.1. Using Institutional Theory to Explain the Country Specific Factors Affecting the Development of Financial Accounting and Reporting

The integrity and usefulness of an institutional approach to explain and interpret accounting activities at an international level has been acknowledged by many authors (Barbu, Farcane, & Popa, 2012; N. Albu, C. N. Albu, Bunea, Calu, & Girbina, 2011; Al-Omari, 2010; Barbu & Baker, 2010; Judge, Li, & Pinsker, 2010; Irvine, 2008; Kury, 2007; Baker & Rennie, 2006; Mezias & Scarselletta, 1994). For example, the American neo-institutional theorist Richard Scott defined institutionalization as "the process by which actions are repeated and given similar meaning by self and others". Sometimes actions are repeated because explicit rules or laws exist to ensure their repetition (*legal and political influences*), sometimes activity patterns are supported by norms, values and expectations (*cultural influences*), sometimes by desire to be or look like another institution (*social influences*) (Hatch, 1997). The institutional approach emphasizes the importance of institutions, as well as such related phenomena as rules, habits, routines, norms and culture. This theoretical framework is useful to understand the accounting change because it "pays attention to history, to the evolution of institutions and to the causal factors of social change" (Albu *et al.,* 2011). Therefore, the institutional theory represents a valuable framework to explain the country-specific factors affecting the development of financial accounting and reporting in Estonia, as an inter-play between practices, routines and institutions.

American sociologists Powell and DiMaggio (1983) distinguish between three different institutional pressures and give them distinctive labels. They argue that when the pressure to conform comes from governmental regulations or laws, then *coercive institutional pressures* are at work. Coercive institutional pressures in this concept involve the capacity to establish rules, inspect others to conformity to them, and, as necessary, manipulate sanctions – rewards or punishments – in attempt to influence future behaviour (Scott, 2001).

When an economy is relatively small and poor, e.g. developing, it is more dependent on international norms and standards than when the economy is relatively large and wealthy. Arguably, the mechanism most used by international non-governmental organizations to coercively bring about change within a national economy is foreign aid. There is some previous accounting literature to support the impact of coercive institutions on the adoption of international standards. For example, Touron (2005) argued that coercive isomorphism was predictive of adoption of the United States GAAP by French firms in the 1970s due to domination of the global economy by the USA at the time. Furthermore, Hassan (2008) found that external coercive pressures from foreign aid provided by the International Monetary Fund (IMF) were influential in Egypt's moving toward the adoption of the IFRSs. (Judge *et al.*, 2010)

Irvine (2008) and Barbu and Baker (2010) observe the IASB as one of the coercive pressures encouraging the countries around the world to adopt the IFRSs. Others believe that implementation of IFRSs in developing economies may help to increase the trust in the accounting information, to attract new investors and resources. Ruder, Canfield and Hollister (2005) state that the fact that various economic systems are converging around IFRS, although there are considerable variations between countries in their accounting standards and practices. This convergence around a worldwide set of standards has important implications for national corporate governance practices, including the Estonian ones. Judge *et al.* (2010) seek to identify what might be the institutional predictors of adoption of the international accounting standards. Using archival data from 132 nations, they find relatively robust support for the institutional perspective on the adoption of the IFRSs. Notably, the comparison of institutional variables (i.e. level of foreign aid, import penetration, the relative education level within a nation) with the cultural and legal variables identified by the previous literature (Ding, Jeanjean, &Stolowy 2005; Hope, Jin, & Kang, 2006) shows the institutional variables are more robust in predicting IFRS adoption. (Judge *et al.*, 2010)

Powell and DiMaggio (1983) take a narrower approach to coercive institutional pressure and observe that as conglomerate corporations increase in size and scope, it is common for subsidiaries to be subject to standardized reporting mechanisms. Subsidiaries most adopt accounting practices, performance evaluations, and budgetary plans that are compatible with the policies of the parent corporation. For example, what allowance for doubtful accounts should be accounted for in the balance sheet or what accounting principles should be used when accounting for inventory. This leads to a pressure on companies in two ways – firstly, the prepared financial statements have to meet the demands of the parent company, who perhaps prepares the financial statements according to the IFRS, and secondly, the subsidiary has to prepare the financial statements according to the local GAAP.

When the pressure comes from cultural expectations, for instance via the professional training of organizational members, then according to Powell and DiMaggio (1983) *normative institutional pressures* are at work. Normative systems are typically viewed as imposing constraints (Scott, 2001). For example, the World Bank requirement that projects financed by the bank be "certified by internationally reputable firms of accountants" has aided in the proliferation of the international operations of the Big 4 international accounting firms (Irvine, 2008). Al-Omari (2010) also views the Big 4 accounting firms under normative institutional pressure as these companies play a profound role in the globalization of accounting and represents the normative pressures that affect organizations and the choices they make in accordance to their reporting and practices implemented. Other authors have also researched the influences of the Big 4 accounting firms on the preparation of the financial statements. Although this analysis has not been made in the context of the institutional theory, they can still be used to assess the influences of the Big 4 accounting companies to the development of accounting practices. Therefore, one can argue that the Big 4 accounting firms play a profound role in the globalization of accounting and represent the normative pressures that affect organizations and the choices they make in accordance to their reporting and practices implemented (Al-Omari, 2010). In Estonia, where the Big 4 auditing firms make up to 88% of the total revenue produced by the ten largest auditing firms (Vetevoog 2009), one can certainly apprehend the pressure from the Big 4 auditing firms to prepare the annual reports according to their requirements. Chand (2005) believes that the Big 4 companies are endowed with an effective presence in the world capital market, and are considered to be one of the many international forces behind the process and advancement of the harmonization of accounting standards.

Most analyses conducted in respect of the Big 4 auditing companies compare the audit quality of the Big 4 auditing firms and other auditing firms. For example, in the United States, the investigation showed that the quality of audits conducted by the Big 4 auditing firms depends on the size of the activities of client. Because the bigger client gets more public attention, the risk of getting sued increases for the auditing firm. Lawrence, Minutti and Zhang (2007) state that when the Big 4 and non-Big 4 companies audit a client of a similar size, the differences in audit quality disappear. Consistent with prior research is also the analysis of Reynolds and Francis (2000) which outlays the fact that the Big 4 companies report more conservatively when it comes to bigger clients. They explain this phenomenon with the fact that with this kind of behaviour, the Big 4 companies try to protect their reputation.

Simunic (1980) argues that the accounting services provided by different accounting firms are perceived by investors to be different in quality, with brand name auditors (currently the Big 4 auditors) perceived as being more credible than others. In line with this argument, Becker, DeFond, Jiambalvo and Subramanyam (1998) and Francis, Maydew and Sparks (1999) have noticed that owing to their superior knowledge and reputation capital, brand name auditors conduct higher-quality audits. This is supported by a study issued by the General Accounting Office of the United States that corroborates the essential aspects in terms of the Big 4 audit outcome. The Big 4 audit opinion serves as an effective quality label, whereas most of the second-tier firms are not able to bid successfully for large because of a lack of industry knowledge, geographic pressure and reputation. According to Gray and Ratzinger (2010), the General Accounting Office of the United States argues that a Big 4 audit report is characterized by a distinctive quality label, and therefore contains credible and high quality information.

Gray and Ratzinger (2010) further researched whether there are differences between the Big 4 firms in particular, how their national offices might interpret some specific accounting or auditing question. In a later focus group, an auditor pointed out that there were frequent conversations between representatives of the different Big 4 firms that resulted in a convergence of their interpretations. For example, when some new accounting or auditing issue arises, that will prompt discussions between the firms. She went on to say that the firms are fairly open in discussing their audit methodologies, so that the methodologies used by the firms are constantly evolving over time. However, the auditors agreed that the differences in interpretations become wider when the Big 4 and non-Big 4 firms are compared (Gray and Ratzinger, 2010). The author of the thesis is of the opinion that the cooperation of the Big 4 companies indicates that the financial statements audited by them may therefore be drafted even more according to their requirements. Sawers (2007) believes that this is why the

British Financial Reporting Council has actively reacted against the dominance of the Big 4 auditing firms and has orientated itself at the international level towards increasing the likelihood of major "public interest entities" selecting non-Big 4 auditors.

Mezias and Scarselletta (1994) and Barbu and Baker (2010) think that in the United States of America, professional accountants constitute examples of normative isomorphism "with a common culture, in the sense of shared definitions of problems and common repertoires for managing those problems". Therefore, participants in accounting policymaking might exhibit high levels of shared knowledge and beliefs, and this professionalization may contribute to a more orderly, consensual process when making decisions. To conclude, theorists embracing a normative conception of institutions emphasize the stabilizing influence of social beliefs and norms, which are internalized an imposed by others (Scott, 2001).

Powell and DiMaggio (1983) call desires to look like other organizations *mimetic institutional pressure* and explain them as responses to uncertainty that involve copying others organizational structures, practices and outputs. More generally, the wider the population of personnel employed by, or customers served by, an organization, the stronger the pressure felt by the organization to provide the programs and services offered by other organizations. Thus, either a skilled labour force or a broad customer base may encourage mimetic isomorphism (Powell and DiMaggio, 1983). Mimetic institutional pressure is viewed differently by many authors. Powell and DiMaggio (1983) see not-for-profit organizations as an example of mimetic institutional pressure. These organizations may change their organizational structure to be more similar to the for-profit firms and carry a powerful message to potential partners in joint ventures that "the sleepy non-profit organization is becoming more business minded".

Barbu and Baker (2010) consider different local accounting standards-setting bodies in various countries to be an evidence of mimetic isomorphism as they have adopted structures and procedures similar to those of the IASB and the FASB. In the opinion of Al-Omari (2010), mimetic institutional pressures refer to the copying and duplicating of successful organizational behaviour by other organizations. Successful multinational corporations have contributed to increasing the desirability of expanding and accepting the global harmonization of financial reporting. Therefore, the sophisticated and developed systems within those corporations portray desirable practices and behaviours which are seen essential and imperative to organizations within the developing economies (Al-Omari, 2010). Irvine (2008) argues that the UAE openness to its globalized environment and its increasing reliance on international trade having been established, it is inevitable that these relationships bring a pressure on the UAE to adopt westernized forms of accountability and financial reporting, particularly those of its "influential trading partner(s)".

Further, organizations require more than material resources and technical information if they are to survive and thrive in their social environment. They also need social acceptability and credibility (Scott, 2001). Zucker (1987) believes that the difference between institutionalized and non-institutionalized environments often appears to be simply a matter of rationality. In this view, the economic success factor is viewed as the product of rational decision making. Conforming to the institutional demands wins social support and ensures survival to an organization, not because it makes more money or better products, but because it goes along with accepted conventions. Therefore, it is understandable how under different institutional pressures not only organizations and firms, but also countries adapt to the demands of the World Bank, the IASB, the Big 4 companies and trade partners to achieve social legitimacy. This kind of behaviour further supports the harmonization of the international accounting standards and the rise of a new international institution. As coercive, normative and mimetic pressures are viewed differently by many authors it is vital to determine which pressures are influencing the development of the Estonian accounting system taking into consideration the accounting history of Estonia, the openness to global processes, and participation in the international capital markets.

2.1.1. Coercive Institutional Pressures

During half a century accounting in Estonia was a part of the Soviet accounting system. The Soviet accounting system applied in Estonia was an integral part of the centralized administrative institutional structures for the direction and control of the command economic system. The collapse of centrally planned economies in the late 1980s and early 1990s changed the accounting environment in the former socialist countries, including Estonia, dramatically. Estonia's economic system was transformed from a centrally planned to a market-based economy, which involved significant legal and institutional changes in regulations and especially accounting regulations and gave rise to the development of a new accounting environment.

After declaring the restoration of the independence of the Republic of Estonia in 1990, it became possible to begin the reform of accounting and join the accounting system of developed market orientated countries. The first step on the way to change the situation was made in 1990, while Estonia remained, albeit reluctantly, a constituent republic of the USSR. On July 6, 1990, the Regulation of Accounting was adopted by the National Government and came into force on January 1, 1991. It is of special interest because it was the first measure adopted in any of the constituent republics of the USSR to mark a departure from the path of the Soviet accounting evolution. As pointed out by J. Alver, L. Alver, Mackevicius, Paupa and Bailey (1998), this event marked the beginning of the spread of accounting disharmony within the territories comprising the USSR. It was really an "accounting step" on the transition from command economy to market economy. Although, legally, the measure was a regulation and not statute (i.e. not approved by a legislative assembly but adopted by the executive action of the government) it was comparable to a fundamental, or basic, accounting law. Paradoxically, in some sense, as pointed out by Bailey (1995), the Estonian Regulation on Accounting, adopted prior to the recovery of independence in 1991, was more considered measure and wider in scope than the legislation introduced subsequently in Latvia and Lithuania. Because of a lack of local accounting sophistication there was some inability to distinguish between the suitable and unsuitable aspects of accounting procedures and practices transferred. Therefore, foreign advice appeared to be of great support in designing local accounting legislations. It is worth noticing that three of the seven members of the Estonian Accounting Board during the period of preparation of the new Accounting Act in 1993–1994 had international working experience.

In 1991 the Estonian Accounting Board (later named the EASB) took on the responsibility for the development of accounting in Estonia. The main tasks of the Board were declared to issue mandatory accounting guidelines and to make recommendations concerning the methods which were to come into force. All the developments of accounting were expected to be initiated and prepared for legislation and implementation by the Board. At that time the EASB was an independent governmental unit, established by the government of Estonia and operating within the administrative jurisdiction of the Ministry of Finance as defined in paragraph 32 (1) of EAA. The EASB had to arrange accounting guidelines related to the EAA.

The first step towards the formation of auditing environment in Estonia was made by the Estonian Regulation on Auditing in 1990 (the Estonian Auditing Act was enforced in 1999). During the following years, 1992–1995, all the “Big Six” audit firms started to operate in Estonia. In 1994 the first set of auditing guidelines was enacted in Estonia.

These steps made an essential contribution to and helped create a favourable environment for the preparation and enforcement of the EAA. However, it is evident that accounting underwent evolutionary changes in the first half of the 1990s. The main problem was as follows: how to build a forward-looking and flexible accounting regulation system, which would enable to overtake and to integrate into the European accounting framework? The traditional system based on the accounting law would be too inflexible to reflect the rapid changes in transition circumstances. Although the Principal Administrator and Head of Accounting at the European Union (EU) Commission Van Hulle (1993) expressed an idea that the use of the law as a means of standard setting can also be an interesting mechanism against too frequent (and sometimes unnecessary) changes. But this was not the case for transition countries, because of a missing stable and effective accounting regulation system.

The Estonian Regulation on Accounting was in force until 1995. This document introduced a number of new accounting concepts and principles, new terms and a new set of annual financial statements (including the balance sheet, the income statement and the statement of changes in the financial position and notes). The main characteristic of that period is that it was mixed from past (some elements of the former Soviet accounting system remained in force), present (real usage of new methods, principles and financial statements) and future (usage of many new terms of market economy which really were not represented in the Estonian economy).

A more substantial and complex step of the accounting reform in Estonia was related to the first EAA which came into effect on January 1, 1995. Chapter 1 of the EAA specified the objective of the EAA, which was to create the legal bases and establish general requirements for organizing accounting and reporting in the Republic of Estonia based on the internationally accepted accounting principles. In paragraph 3 of the EAA the internationally accepted accounting and reporting principles were defined as the accounting directives of the European Community and the principles, standards and recommendations developed and approved by the International Accounting Standards Committee (the IASC – later named the IASB). The annual financial statements included the balance sheet, the income statement and notes. The statement of cash flows was a compulsory part of notes. (Estonian Accounting Standards Board, 2000)

Estonia was one of the first nations in Europe to align the national GAAP with the international accounting standards by law. According to J. Alver and L. Alver (2009), the Accounting Act of 1995 stated that the Estonian good accounting practice (the Estonian GAAP) is based on the standards, interpretations and guidelines promulgated by the IASC. The true and fair view was declared to be the most important reporting principle but still the Accounting Act did not contain a detailed set of rules and can best be characterized as constituting a legal framework. The legal framework was general and applied to all legal entities and physical persons registered as businesses in Estonia (J. Alver & L. Alver, 2009).

The Estonian GAAP was declared to be based on internationally recognized principles, which were established with the Accounting Act and the Estonian accounting guidelines. In some sense, this concept was a unique combination of Anglo-American approach and Continental (European) approach. According to Haldma (2003), in the Estonian accounting regulation the Accounting Act represents the European approach and the Estonian GAAP – Anglo-American approach. Such combination had a number of advantages, especially in the first period of creation of accounting regulation (transition period) and enabled the flexible manner of the transition process. The analysis of the accounting regulations in the Eastern and Central European countries revealed that, besides Estonia, only Slovenia has introduced the mentioned double set accounting regulation. In the second half of the 1990s this approach was implemented in several market economy countries – for example in Germany, Norway, Sweden (Haldma, 2003).

From 1995 to 2000 the EASB issued 16 guidelines to improve particular aspects of accounting in Estonia including accounting principles, preparation of financial statements, revenue recognition etc. The only problem was that the guidelines were not obligatory. They were only recommendations and in case of contradictions with the Accounting Act, requirements of the Accounting Act had to be followed.

The first Accounting Act was in force from 1995 to 2002 and was changed several times. Unfortunately, these changes were mostly cosmetic (J. Alver & L. Alver, 2009). The first Accounting Act of Estonia had considered the valid international accounting requirements, as well as the majority of the requirements of the 4th Directive of EU. In November 1995 the Government of Estonia submitted an official application to join the EU. As the Government of Estonia had expressed Estonia's desire to enter the EU, the EASB merged the requirements of the European directives with IASC's conceptual framework and treatments by carefully choosing the alternatives in the directives that result in convergence.

The accounting reform continued by the implementation of the new version of the EAA and a new set of guidelines. Both of them came into effect on January 1, 2003. The goal of the EAA was declared to create the legal basis and establish general requirements for organizing accounting and financial reporting pursuant to internationally recognized principles. The new Accounting Act modified also the status of the EASB, which became an independent commission. Instead of the former two basic statements (the balance sheet and the income statement) the annual report now included four statements: the balance sheet, the income statement, the cash flow statement and the statement of changes in owner's equity (J. Alver & L. Alver, 2009)). The new Accounting Act brought the Estonian accounting legislation closer to the International standards and also contributed to a better organization of the economic environment. The financial reports by business entities became more informative and enabled different interest groups to have a better overview about the reporting company's financial position, including assets and liabilities (Tikk, 2010).

The main characteristic of the new EAA and guidelines is clear orientation to the IFRSs and the possibility to base the accounting methods and presentation of the information in financial statements according to the Estonian GAAP or the IFRSs. The Estonian GAAP is basically a simplified summary of the IFRSs, primarily meant for small and medium-size entities. The recognition and measurement rules are based on the IFRSs, but the disclosure requirements are less demanding (EASB webpage).

To further understand the coercive pressures, including organizations and events that affected the development of the Estonian accounting system, the author of the thesis has focused on the system improving stage starting from 2003.

In May 2004, the Republic of Estonia joined the EU. From this day forward, Estonia has the obligation to follow in its activities the legislation of the EU. The main sources of primary law are the Treaties establishing the EU. Secondary sources include regulations and directives that are based on the Treaties. Regulations, directives and decisions are mandatory to follow for member states (European Union Information Centre). Although sometimes directives set quite specific objectives, they leave the implementation to the EU's member states. Regulations are directly applicable to member states and take effect without the need for implementing measures (European Union Information Centre).

In 2004 the financial reporting in the EU was regulated by the Fourth Council Directive 78/660/EEC (in force since July 25, 1978), which treated the preparation of annual financial statements of certain types of companies, and the Seventh Directive

83/349/EEC (in force since June 13, 1983), which defined the preparation of consolidated statements. The above-mentioned directives were incorporated in the EAA when joining the EU. Because the Fourth and Seventh Directive were not based on the IFRSs, differences between the Estonian guidelines and the EU legislation existed in 2004.

However, there was no need to improve the Estonian GAAP, because according to the regulation accepted by the European Parliament and European Council in 2002 (1606/2002), all EU listed companies were required to prepare their consolidated statements in accordance with the IFRSs. This requirement entered into effect from 2005 and represented a preliminary peak in the internationalization process of financial accounting in Europe. For other companies the implementation of the IFRSs is recommended. Although the Estonian GAAP was already oriented to the IFRSs, all guidelines were amended again (Tikk, 2010), because differences between the international accounting standards adopted by the EU and accepted by the IASB existed. The main reason for the differences is that the IFRSs adopted by the IASB do not take effect in the EU automatically.

On December 1, 2005 several changes were introduced in the EAA. With the updated Accounting Act the necessity of providing the users of financial statements with adequate information was emphasized. Besides, the EAA required more information in the management report, such as the description of the main fields of activity as well as products and services and also the main financial ratios. Guidelines, which were oriented to the IFRSs, already required this kind of information to be disclosed in the notes of the annual report. With the updated version of the EAA, this requirement was also introduced to the law. Thus, the demand for change in the law was determined by the IFRSs.

In 2007 the EAA was amended again. According to Loot (2007), the reason for the amendments was the necessity to follow the disclosure principle in all business transactions or events, where a business entity issuing securities is one of the parties. The change was intended to harmonize the European Parliament and Council Directive 2004/39/EC (the Markets in Financial Instruments Directive) and implement Directive 2006/73/EC and 2004/109/EC (the Transparency Directive). Thus, the demand for the change in the EAA was determined by the EU legislation.

The amendments in the EAA that came into force in 2008 required that the annual report should disclose the entity’s main field of activity according to the Classification of Economic Activities used in Estonia. According to the explanatory memorandum, such amendment provides for quick identification and processing of registers maintained by the court. The EASB and the Estonian Board of Auditors (the EBA) saw the change in the context of the annual report inappropriate and suggested that such information should be collected outside the annual report. As a result, such information shall be published after the notes and annexes to the annual report (Loot, 2008). Thus, the change in the law was rather administrative in nature, which was designed to help users (registration departments of courts) to better process the data.

In 2009, several changes were introduced to the EAA. The main change worth noting was the development of uniform financial reporting taxonomy, which was directly related to the action plan for e-filing of the annual reports. Firstly, the taxonomy of the annual report that meets the Estonian GAAP was developed (except the taxonomy on consolidation or liquidation and the final report) (Loot, 2009). Taxonomy was introduced in 2010. As the electronic submission of annual reports is not widespread throughout the world, the author thinks that it can be seen as an independent project of Estonia, which can be qualified as exceptional in the world. Therefore, in this case, the compelling institutional pressure is the Republic of Estonia, who has been able to set rules and has the ability to see that others follow these rules.

In 2010 the EAA was amended again influenced by the changes in the Auditing Act (it was updated because of the requirements of the International Standards on Auditing). To draw a parallel here, to merge with the demands of the international legislation other Estonian laws besides the EAA have been influenced by international standards and organizations.

In 2011 the changes in the EAA were the result of Estonia's accession to the euro area and the substitution of the national currency from the Estonian kroon to the euro. The functional currency changed to the euro instead of the kroon as well.

In conclusion, it may be noted that due to the membership of the EU, the coercive institutional pressure affecting the development of the Estonian accounting environment is the previously mentioned EU. The legislation of the EU (regulations and directives) directly influences the EAA. As the EU has based its accounting regulations mainly on the IFRSs, then in the international perspective one can rather see the IASB as the main coercive institutional pressure affecting the development of the EAA and the Estonian GAAP.

At societal level there have been many discussions, what the Estonian GAAP should look like in the future. The chairman of the EASB Ago Vilu sees the Estonian guidelines remaining closely tied with the IFRSs. This view is supported by the adoption of the IFRS for SMEs by the IASB in 2009 (Oja, 2011). In the EU the use of the IFRS for SMEs has not been approved, because according to the European Commission, IFRS for SMEs is not suitable to use for micro-enterprises (Hirvoja-Tamm, 2010) and it is not in line with the Fourth and Seventh Directive of the EU (Hirvoja-Tamm, 2010). Therefore, in October 2011, the European Commission decided not to adopt the IFRS for SMEs into the European legislation. Furthermore, the Commission proposed to simplify accounting rules for SMEs by amending the Accounting Directives (78/660/EEC and 83/349/EEC). With that the Commission aims to reduce the administrative burden for small companies. Simplifying the preparation of financial statements would also make these more comparable, clearer and easier to understand. It would also allow users of financial statements such as shareholders, banks and suppliers to gain a better understanding of companies' performance and financial position. Furthermore, under the proposed revision of the

Transparency Directive (2004/109/EC), listed companies (including small and medium-sized issuers) would no longer be obliged to publish quarterly financial information. This would contribute to further cost savings and should help to discourage short-termism on financial markets (European Commission 2011a, October 25). In December 2011 the proposals to revise the accounting Directives and the Transparency Directive were approved by the European Parliament. After formal approval by the Council, the Directive will enter into force following publication in the Official Journal (European Commission 2011, December 14). Member States should take into account the specific conditions and needs of their own markets when making decisions about how or whether to implement a micro-entity regime within the context of Council Directive 78/660/EEC (The European Parliament and the Council, 2012). The Commission hopes that most Member States will see this as an opportunity to reduce the burden on the smallest companies within their jurisdiction. By aligning the micro entities' financial reporting requirements with other reporting requirements (such as tax reporting, for example) they can create a one-stop-shop and substantially reduce the reporting burden (European Commission 2011, December 14).

According to the new Accounting Directive 2013/34/EU, a micro-entity is a company which does not exceed at least two of the following three criteria: total assets of up to 350,000 euros; net turnover of up to 700,000 euros; and a maximum of 10 employees and typically have limited liability towards third parties. Approximately 75% of EU companies meet these criteria. According to the Estonian Statistical Office 58,347 companies were operating in Estonia in 2010. From these companies 51,854 entities had less than 10 employees, which is 89% of all the companies (Statistics Estonia, 2012). Therefore, one can argue that the Estonian micro-entities may be interested in adopting the new regulation in Estonia as well.

So far, the majority of the Estonian enterprises prepare their annual financial statements according to the Estonian GAAP, which copies the accounting principles of the "big" IFRS. In 2011, several changes were introduced to the guidelines that became effective from January 1, 2013. The new guidelines follow mainly the IFRS for SMEs, although some differences exist between two sets of accounting rules.

Estonia is among the first countries in Europe aligning its local accounting standards with the IFRS for SMEs. The same process has been started by many other countries in Europe, for example, Great Britain, the Netherlands and Denmark (EASB webpage).

In the light of the recent events (on the one hand, Estonia aligning its accounting guidelines with the IFRS for SMEs, and on the other hand – the EU banning the IFRS for SMEs and creating simplified rules for micro-enterprises) it is hard to predict, what will happen in the future and whether Estonia will follow the guidelines set by the EU or the IASB or both. Still, the recent and the future developments further support the fact that the EU and the IASB are the main two coercive institutional pressures affecting the development of the financial accounting framework in Estonia.

2.1.2. Normative Institutional Pressures

One can argue that the development of the accounting legislation in Estonia is also under pressure of the Big 4. This can be proved by the fact that from 2001 the members of the EASB have included 3–4 auditors and the chair of the EASB has been from the Big 4 (EASB webpage).

According to the Auditing Act[3] § 158, the auditing firm, who is in a contractual relationship with a public interest entity, must compose and report the transparency report to the Estonian Board of Auditors. Therefore, the transparency reports of the Big 4 and other Estonian companies are analysed to determine the normative pressure of the Big 4 auditing firms in Estonia.

For the purposes of the Auditing Act, a public interest entity is:

> 1) a company whose securities are admitted to trading on a regulated securities market within the meaning of the Securities Market Act;
> 2) a company which is a credit institution within the meaning of the Credit Institutions Act;
> 3) a company which is an insurer within the meaning of the Insurance Activities Act;
> 4) a local government in the administrative territory in which more than 10,000 people live as at the balance sheet date or the total assets of which indicated in the annual financial statements or in the annual financial statements of the consolidation group as at the balance sheet date exceed 20,000,000 euros;
> 5) a ministry as a state accounting entity within the meaning of the Accounting Act.

Furthermore, public interest entity is a legal person in whose financial statements or in the annual financial statements of whose consolidation group at least two of the indicators of the financial year exceed the following conditions:

> 1) sales revenue or income 66,000,000 euros;
> 2) assets as of the balance sheet date 33,000,000 euros;
> 3) average number of employees 1,000 persons.

According to the Auditing Act a public interest entity is a company, foundation, non-profit association or other legal person, in which the public sector entity has a majority holding or which is under the dominant influence of the public sector entity, in whose annual financial statements or in the annual financial statements of whose consolidation group at least three of the indicators of the financial year exceed the following conditions:

[3] In accordance with the European Union Directive 2006/43/EU which treats the audit of consolidated and non-consolidated annual reports.

1) sales revenue or income 14,000,000 euros;
2) assets as of the balance sheet date 7,000,000 euros;
3) average number of employees 200 persons;
4) number of members of the supervisory board 8 persons.

Besides the number of public interest entities audited during the financial year, the auditing firm is also obliged to present the amount of revenues gained from the assurance services in the transparency report. This includes revenues gained from performing audits, reviews and other assurance services.

Therefore, the author has analysed more thoroughly, how many public interest entities in Estonia are audited by the Big 4 companies and how the revenues from the assurance services are divided between the Big 4 and non-Big 4 companies. Based on this analysis it is possible to draw some initial conclusions, how Big 4 companies exercise their normative pressure on Estonian companies, on the development of the Estonian accounting framework and audit quality.

According to the homepage of the Estonian Board of Auditors, 18 auditing firms have presented the transparency report for the period from 1 July 2012 to 30 June.2013. Based on the data reported by the auditing firms, 184 public interest entities have been audited during that period from which the Big 4 companies have audited 68%[4]. Based on these results it can be argued that as most of the "important" annual reports are being audited by the Big 4 companies then due to reputation risk they perform the audits more conservatively than other auditors and therefore influence the preparation and presentation of the annual reports they audit.

When we look how the sales revenue is distributed during the same period between the Big 4 and non-Big 4 companies, we can see that in total the auditing firms presenting transparency reports earned revenues of 14.7 million euros. The revenues of the Big 4 companies made up to 10.7 million euros, which is 72% of the total revenues earned during that period[5]. When we look at public limited companies, who are also public interest entities, in more detail, we can see that the annual reports of 13 public limited companies out of 13 listed on the Tallinn Stock Exchange in 2013 have been audited by the Big 4 companies. Based on that one can say that the impact of the Big 4 companies on the preparation and presentation of annual reports and thereto, national law, extends beyond public interest entities as the revenues earned also include auditing of non-public interest entities.

To conclude, the author can say that based on the analysis of sales revenue the impact of the Big 4 companies on the preparation and presentation of annual reports extends beyond public interest entities as the revenues earned also include auditing of non-public interest entities. Although no law requires that the audit or the review of the

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[4] The analysis is conducted by the author based on the transparency reports.
[5] The analysis is conducted by the author based on the transparency reports.

annual reports have to be conducted by the Big 4 auditing firms most of the public interest entities have chosen the Big 4 companies to do the job.

If we look at the substance of the annual reports then the research conducted in Estonia shows that there are considerable differences between the audit quality of the Big 4 and non-Big 4 companies. Kannistu (2008) studied the annual reports of 15 Estonian companies from which 8 annual reports were audited by the Big 4 companies and 7 from non-Big 4 companies. Important substantive errors, which include recognition of business transactions, appeared according to Kannistu (2008) only in those annual reports, which were audited by non-Big 4 companies.

Errors in disclosure, which means that the information required by the law to be disclosed was not disclosed or was disclosed partially, appeared in the annual reports audited both by the Big 4 and non-Big 4 companies. Furthermore, there were more errors in the annual reports audited by non-Big 4 companies (Kannistu, 2008). The most common mistake was the insufficient description of the accounting principles in the notes to the financial statements and the non-disclosure of the information for individually significant financial objects and transactions (Kannistu, 2008).

Raigla (2007) studied the information disclosed in the notes to the financial statements. Her sample consisted of 20 non-audited financial statements. With her research Raigla (2007) wanted to show that the non-audited financial statements contain more errors and deficiencies than audited financial statements. The investigation revealed that the sampled annual reports did not use cross-references, the numerical values of notes and financial statements differed, the terminology used was insufficient, disclosed information was often inadequate or even wrong (Raigla, 2007). Detected errors on non-audited annual reports were therefore even more extensive than those identified by Kannistu on audited annual reports.

The work performed by Raigla (2007) is supported by a study conducted by the authorised public accountant Villems (2008), who also investigated the most common errors on the annual reports. According to Villems (2008) the annual financial statements commonly do not include detailed notes for the income statement and the statement of cash flows. The review of accounting principles used is superficial and there are problems in how to reflect finance and operating leases.

According to the research conducted by the World Bank in 2004, the differences in technical proficiency of Estonian auditors result in significant differences in audit quality. High-quality audit delivery can be expected from select audit firms representing approximately 25 percent of profession. Furthermore, the research points out that although there is a significant improvement in the quality of public interest entities audit, the audit quality in SMEs lags behind. The reason behind it is that most sole practitioners and auditors employed in small audit firms do not have access to an audit practice manual. Lacking knowledge about how to apply the International Standards on Auditing (ISAs) many Estonian auditors only use the Estonian auditing guidelines, albeit not properly. The author is of the opinion that in 2011 the situation improved compared to the situation in 2004 as in 2010 the new Auditing Act was adopted. The new Auditing Act was developed based on the ISAs. To retain their status as authorised public accountants all authorised public accountants have to retake the auditor's exam, which is based on the new auditing law and ISAs.

According to the investigation conducted by the World Bank and other researchers, one can expect a higher quality of the annual reports audited by international auditing firms. This suggests that in Estonia the impact of the Big 4 companies on presentation of financial statements is significant, as they audit most of Estonian public interest entities and therefore directly influence the preparation and presentation of the financial statements and the development of the Estonian financial accounting and reporting framework.

2.1.3. Mimetic Institutional Pressures

Mimetic institutional pressures refer to the copying and duplicating of successful organizational behaviour by other organizations (Powell and DiMaggio, 1983). This is mostly used in situations and conditions of uncertainty, when "institutional rules" are replaced by "technical rules" in this case the organization will decide to mimic similar, larger, or more successful organizations. Organizations, as humans, want to be seen as socially acceptable, and not as outsiders. So, the more organizations behave in a certain manner and practice certain procedures, the more pressure there will be on other organizations to copy these behaviours and follow in the same path (Al-Omari, 2010).

The mimetic view therefore stresses conformity with orthodox structures and identity, particularly in times of uncertainty. As successful multinational corporations have expanded their "global reach", they have instituted sophisticated systems of "financial coordination" of their subsidiaries and have modelled to other organizations the desirability of the global harmonization of financial reporting. Intimately connected with the regulatory regimes of the dominant nation states, they have reinforced the desirability, for developing and emerging economies, of conformity with the practices both of multinational corporations and of nations' trading partners (Irvine, 2008).

The collapse of the Soviet Union in the early 1990s marked the breakdown of the centrally planned economy and the need for a new business model in Central and Eastern Europe, including Estonia. In the transformation process, Estonia directed its course from the centrally planned economy to the market economy. This required significant changes in the legislation (including accounting guidelines) as well as in the structures and working principles of different organizations and entities. Because the rest of the world already had had "an experience" in the market economy, it was easier to copy the traditions and practices of entities already operating in the environment of the market economy than to come up with something new. This was supported by the formation of branches of international corporations in Estonia immediately after becoming independent.

Nowadays, the trend to copy the structures, customs and outputs of the international companies, has not disappeared in Estonia. This is supported by the tax policy. To increase the amount of direct investments made in Estonia, the Estonian Parliament passed the Income Tax Act which came into force on January 1, 2000. With the amended law, the entities operating in Estonia must pay the income tax on profit only when it is distributed, not earned.

The changed tax environment promoted the growth of foreign investments in Estonia. The "immigration" of organizations increased even more after Estonia joined with the EU. This gave the international corporations more confidence in the business environment in Estonia, which was from that moment forward subject to the common practices and regulations of the EU. Nowadays, when the key to the financial success and a way out of the economic recession seems to be export, it is inevitable and essential to conform to the requirements of international trading partners.

Barbu and Baker (2010) consider different local accounting standards-setting bodies in various countries to be an evidence of mimetic isomorphism as they have adopted structures and procedures similar to those of the IASB and/or the FASB. A good example is Estonia. Similarly to the FASB the EASB has seven members who represent different professional bodies. Thus, the aim of the creation of the EASB shows the appearance of mimetic pressure. The author believes that it is possible to draw some parallels between the standard setting processes of the EASB and the IASB too.

The purpose of the IASB is to develop a single set of high quality, understandable, enforceable and globally accepted IFRSs, to promote the use and rigorous application of those standards and to bring about convergence of national accounting standards and IFRSs to high quality solutions (IASB homepage). The EASB operates on a similar basis. The function of the EASB is to issue financial accounting and reporting guidelines explaining and specifying the EAA and to direct activities in the field of accounting. The standard development process is also similar for the two organizations – the EASB announces the drafts of the new guidelines and the guidelines already accepted at its webpage.

To conclude, the development of the Estonian GAAP is, on the one hand, influenced by the coercive institutional pressure – the EASB follows the IFRSs when drafting the guidelines. On the other hand, this kind of behaviour is directly influenced by mimetic institutional pressure because the EASB copies the practices of the IASB.

2.2. Concluding Remarks on Institutional Pressures Affecting the Development of Financial Accounting and the Reporting Framework in Estonia

As coercive, normative and mimetic institutional pressures are viewed differently by many authors it is vital to determine which pressures are influencing the development of the Estonian accounting system taking into consideration the accounting history of Estonia in 1990-2012, the openness to the global processes and participation in the international capital market.

The results of the author's research showed that in the context of coercive institutional pressure the development of the accounting legislation in Estonia has been mostly influenced by the IFRSs. These standards have been incorporated in the legislation of the EU, although some differences between the IFRSs issued by the IASB and the IFRSs adopted by the EU exist. As Estonia is a member country of the EU, the effect of the EU legislation on the Estonian standard setting process and the Estonian Accounting Act seems to be quite clear. However, in the light of the recent events, it seems that Estonia has the opportunity to follow its own way when deciding which accounting principles should be applied to micro-enterprises as well as small- and medium-size entities. Therefore, it will be interesting to follow, whether the coercive pressures from the IASB and/or the EU will determine the future financial accounting and reporting legislation for most of the Estonian entities.

The author agrees with Al-Omari (2010) that in respect of normative institutional pressure the "Big 4" firms play a profound role in the globalization of accounting and represent the normative pressures that affect organizations and the choices they make in accordance to their reporting and practices implemented. In Estonia the "Big 4" firms audit most of the public interest entities and can therefore influence the preparation and presentation of their financial statements. So it could be supposed that normative institutional pressures, affecting the development of the Estonian financial accounting and reporting system, are the "Big 4" audit firms. Further research in this area is needed to confirm or exclude the normative institutional pressure. This can be done by comparing the annual reports audited by "Big 4" and "Non-Big 4" firms. The analysis should be conducted in a way that does not only point out the variations from the existing law, but also points out the aspects that are disclosed "voluntarily" and that are common to all "Big 4" firms.

International corporations, whose structures and practices were copied by the Estonian entities after the collapse of the centrally planned economy in the 1990s, can be viewed in the context of mimetic institutional pressure. The trading partners of the Estonian companies, whose requirements have to be met in order to increase the export, can also be viewed as a mimetic institutional pressure. Mimetic institutional pressure does not appear in the context of business only, where entities copy the practices of successful multinational corporations. This copying of the structures and practices may also happen, when the EASB follows the same working principles and processes as the IASB.

The aim of this Chapter was to discuss and to analyse the evolution of the financial reporting model in Estonia with an emphasis on issues within the context of different institutional pressures. The example of Estonia shows that countries that want to be successful in the international capital markets, have to be compatible with different institutional pressures.

3. OVERVIEW OF SMALL AND MEDIUM-SIZED ENTITIES AND THEIR FINANCIAL STATEMENT USERS AND USES

The aim of Chapter 3 is to give an overview about the users of financial statements of SMEs, their information needs, the legal environment created for SMEs for financial accounting and reporting purposes and to map the results. The chapter starts with defining the term "SMEs" that will be used in this dissertation. The author believes that this is important to do as the basis for defining SMEs can be qualitative and / or quantitative and the prior research about SMEs has used different measures when analysing SMEs. Secondly, the author has concentrated on the need for differential reporting in respect of SMEs, which in accounting literature is known as the "Big GAAP" versus "Little GAAP" debate, and the barriers faced by SMEs in realizing the benefits of accounting standards. Thirdly, one sub-chapter covers the previous research of scholars around the world on the users of the SME financial statements and their information needs. The author has also focused on the criticism about prior research that on the same subject. Finally, the author has concentrated on the accounting legislation affecting SMEs in the EU and its member states. The author has also analysed the developments of SME accounting legislation at the international level (by IASB), because according to Chapter 2, the EU and the IASB were seen as the main coercive pressure affecting the financial reporting framework in Estonia. Therefore, the author believes it is important to analyse the future perspectives of the Estonian SME accounting environment and to compare the actual needs of SME financial statement users in Estonia to the options available in the EU accounting legislation. The work in Chapter 3, analysing the information needs of financial statement users, should be the basis for Chapter 4, where the author has focused on identifying and defining the financial statement users and their information needs in Estonia from the perspective of SMEs to understand, whether the current financial reporting standards effective in Estonia satisfy the needs of the users.

3.1. Definition of Small and Medium-Sized Entities

The term "small and medium-sized entities" (SMEs) exists in the economic literature, regulations, statistical data collection *et cetera*. However, there is no single definition of the term. Different application areas, industry sectors and countries may have different definitions for the same term. SMEs are not a homogeneous group, but are divided into micro-, small- and medium-sized enterprises. When accepting differential reporting it must be decided what criteria will be used for distinguishing different classes of reporting entities. Whether these should reflect cost/benefit considerations or whether the criteria should be qualitative (such as public accountability, separation between management and ownership) as well as quantitative (such as economic size) in nature?

Many researchers have struggled with the question of defining relevant criteria for SMEs (Roberts and Sian 2006). In the UK, for example, an early qualitative definition was offered by the Bolton Report (1971) which required the enterprise to have a "relatively small market influence," while being "managed by its owners," and to be "independent in the sense that it does not form part of a larger enterprise" (Burns 2007, 14). Depending on the purpose of the definition of SMEs both qualitative and quantitative factors are defined. Qualitative definitions highlight the qualities that distinguish small businesses from large enterprises. For example, to be classified small, a small business must have at least two of the following features according to Byrd and Megginson (2009, 8):

- Management is independent, because the manager usually owns the business;
- Capital is supplied and ownership is held by an individual or a few individuals;
- The area of operations is primarily local, although the market is not necessarily local;
- The business is small in comparison with the larger competitors in the industry.

According to the IFRS for SMEs developed by the IASB (2009a) SMEs are entities that (a) do not have public accountability, and (b) publish general purpose financial statements for external users. Examples of external users include owners who are not involved in managing the business, existing and potential creditors, and credit rating agencies. The definition of SMEs developed by the IASB is more qualitative in nature. The author believes that for a direct implementation in accounting legislation the definition of SMEs by the IASB is too general and in practice it should be clarified. The IFRS for SMEs standard remains unclear where the boundaries are located between micro-, small-, medium- and large enterprises as these are not a homogeneous group to whom the same rules fit. For example, it is likely that for micro businesses the simplified IFRS may remain overly burdensome.

As proven by the definition of SMEs by the IASB, when defining SMEs, qualitative criteria are certainly informative, but it is often difficult to use. Therefore, in practice, most preferred criteria to define SMEs are quantitative such as number of employees, revenue, balance sheet amount etc. Still, it should be noted that using quantitative measures has also been criticized. For instance, employee numbers can be distorted by the increasing use of part-time employees, casual workers and outsourcing while balance sheet figures depend upon the specific rules used. Even revenue figures are sometimes difficult to ascertain for unincorporated enterprises which are not required to make such information publicly available and, indeed, may not even have accurate accrual based turnover information themselves (Roberts and Sian, 2006).

In a single market of the European Union it is essential that measures of SMEs are based on a common definition to improve their consistency and effectiveness, and to limit distortions of competition. This is all the more necessary given the extensive interaction between national and European Union measures to help SMEs in areas such as regional development and research funding. (European Commission, 2003)

The definition of micro-, small- and medium-sized entities in this dissertation lies heavily on the criteria defined in Directive 2013/34/EU of the European Parliament and of the Council of 26 June 2013 on the annual financial statements, consolidated financial statements and related reports of certain types of undertakings, which amended Directive 2006/43/EC and repelled Council Directives 78/660/EEC and 83/349/EEC. The main reason for using the criteria defined by Directive 2013/34/EU is that as Estonia is part of the EU and the EU is one the most important coercive pressure affecting the Estonian financial reporting framework, Estonia is obliged to transpose this directive to our accounting legislation. The criteria defined for micro-, small- and medium-sized entities in that directive is summarised below in Table 1.

Table 1. Size categories of micro-, small- and medium-sized entities based on Directive 2013/34/EU

	Medium-Sized Entity	Small-Sized Entity	Micro-Sized Entity
Criteria	Entities which, on their balance sheet dates, do not exceed the limits of two of the following three criteria: a) balance sheet total of not more than €20,000,000; b) net turnover of not more than €40,000,000; c) average number of employees during the financial year not more than 250.	Entities which, on their balance sheet dates, do not exceed the limits of two of the following three criteria: a) balance sheet total of not more than €4,000,000; b) net turnover of not more than €8,000,000; c) average number of employees during the financial year not more than 50.	Entities which, on their balance sheet dates, do not exceed the limits of two of the following three criteria: a) balance sheet total of not more than €350,000; b) net turnover of not more than €700,000; c) average number of employees during the financial year not more than 10.
Remarks	N/A	Member States may define thresholds exceeding the thresholds in points (a) and (b) of the first sub-paragraph. However, the thresholds shall not exceed €6,000,000 for the balance sheet total and €12,000,000 for the net turnover.	N/A

Source: composed by the author based on the accounting Directive 2013/34/EU

It should be noted that with the new Directive 2013/34/EU, the criteria determine to which category an enterprise belongs to, has changed. The balance sheet total and net turnover have increased in respect of medium-sized and decreased with regards to small-sized entities.

For statistical purposes, SMEs are generally defined as those enterprises employing fewer than 250 persons (Eurostat, 2013). Therefore, in some areas of the dissertation, the author has used a simplified approach for SME definition and not the definition used in the Directive 2013/34/EU. This is due to the fact that the data about the SMEs is not always publicly available about all the three thresholds set in the accounting Directive, but it is easier to receive information about SMEs, when defining them based on the number of employees.

3.2. Pros and Cons of Differential Reporting

The term differential reporting represents the idea that different sized entities should be subject to different accounting rules. The debate over its pros and cons in the literature is also referred to as the debate of "Little GAAP" and "Big GAAP". A common argument in the debate is that large companies have complex transactions and that they provide highly aggregated information, which requires specific rules to deal with them (e.g. accounting for business combinations). However, such complexities are rarely relevant to small companies (Collis and Jarvis, 2003).

Heinsaar (2010) in her master thesis has compiled the main pros and cons of differential reporting (refer to Table 2) based on the research of Harvey and Walton (1996) and Collis and Jarvis (2003).

The author of the current dissertation believes that the arguments to support differential reporting are rather practical based on the direct interests of preparers, users and standard setters. Arguments against differential reporting, as outlined in the research by Heinsaar (2010), are more subjective and conjectural in nature. The author of the current dissertation has taken the analysis of pros and cons of differential reporting further by reviewing the research by other authors in this area.

The need for differential reporting is primarily based on the following two important pro's: 1) financial reporting is disproportionately burdensome for smaller entities, and 2) the information provided should meet the needs of the users.

Table 2. Pros and cons of differential reporting

Pros	Cons
The preparation cost of financial statements for small entities is proportionally higher compared to the big ones.	Accounting rules can only be universal, since all financial statements must give a true and fair view of the entity's business activities.
Accounting rules should be based on the needs of particular users. The financial statements of large entities have a much broader range of users than small entities as the latter are mostly managed and controlled by the owners.	Accounting rules must encourage financial statements to be comparable and reliable. When the rules differ, there can be no talking of comparability.
In smaller entities, there is no agency relationship between owners and managers.	If the user's needs are similar, then the general public expects all entities to comply with similar accounting rules.
Large entities are involved in more complex financial transactions, which require special rules that are not relevant for smaller entities.	Different accounting rules put small businesses in a "lower" class.
The information presented in the financial statements must be understandable. The users of the financial statements of smaller entities are not as "knowledgeable" about financial reporting than the users of those of large companies.	Being a limited liability company means obligation to be in compliance with all reporting and disclosure requirements, even if it results in higher costs to the company.
The information presented in the financial statements should support decision-making. Financial statements of large entities are used in a wider range of decision-making. Thus, only in their case the extensive disclosure requirements can be justified.	The simplification of the accounting rules for small entities will also encourage greater demand for similar relief for larger entities.
The existence of two different systems of standards makes the development of the standards more efficient because it is possible to focus on the entities to which the standards are targeted.	Distinguishing the reporting rules will lead to the division of the accountant profession into higher and lower classes.

Source: Heinsaar (2010, 12) (translated from Estonian into English by the author)

It has been argued by researchers that the promulgation of complex and detailed accounting standards has put a significant strain on the resources of small business (Wallace and Wortmann, 2003; Eierle, 2005; Maingot and Zeghal, 2006; Rennie and Senkow, 2009). When all companies are required to apply the same GAAP, smaller companies endure a proportionately higher financial burden to prepare financial statements and obtain an unqualified audit opinion on those financial statements. Eierle (2005) argues that not all enterprises enter into complex transactions and therefore, need complex accounting rules which are costly to apply by terms of hiring consultants (Walton and Harvey, 1996, referred in Eierle 2005). In addition, small enterprises especially may incur relatively higher costs for complying with financial reporting requirements, because they are not able to benefit from the economies of scale enjoyed by larger firms (Murray & Johnson, 1983, referred through Eierle 2005). Therefore, cost/benefit considerations regarding the provision of financial information may differ between enterprises. The smaller the user group of a company's financial statements and the greater their ability to gain access to information in addition to that included in financial statements, the greater the likelihood that the costs of providing accounting information in financial statements outweigh the resulting. (Eierle, 2005)

That is why the European Union in its recent activities also views the preparation costs of financial statements for small entities as a main reason for differentiating the reporting requirements for SMEs. In 2009, the European Commission made a proposal to amend Council Directive 78/660/EEC in respect of micro-entities. The main reason was that according to the estimations available to the European Commission there are around 5.3 million micro-entities in the EU that meet at least two of the definition criteria (i.e. companies which on their balance sheet dates do not exceed the limits of (a) balance sheet total: 500,000 euros, (b) net turnover: 1,000,000 euros, (c) average number of employees during the financial year: 10). It costs on average 1,558 euros per company to meet the reporting obligations of the Accounting Directives. It was assessed that without any legal obligations companies would still spend around 25% of that amount to meet their managerial and external information needs. Therefore the remaining 75% or 1,169 euros is an approximation of the accounting burden these companies face. This amounts to an accounting burden of 6.3 billion euros. Thus, in the maximum scenario where all Member States exempt micro companies and do not impose additional requirements the best estimation of the potential savings stemming from the proposal is 6.3 billion euros (with the range of 5.9 billion to 6.9 billion euros). (European Commission, February 26, 2009). There is no information available in the proposal or on the website of the European Commission from which research these cost numbers are derived. Also, taking into account that in the final version of the new directive the criteria for defining micro-entities have lowered, the potential accounting burden is somewhat smaller as fewer entities meet the requirements to be called micro-entities.

In 2011, there were 55,458 actively operating companies in Estonia that had fewer than 10 employees and whose average balance sheet total was 347 thousand euros at the end of the financial year[6]. Based on these numbers the accounting burden these companies face is in the maximum amount approximately 65 million euros[7]. Taking into account that the planned revenues of the Estonian state budget for 2013 are approximately 7.5 billion euros, the costs one could eliminate by introducing simplified rules for SME financial statements make up 0.87% of the annual state revenues. Although the amount of money the companies could save is relatively high

[6] Data retrieved from the website of Statistics Estonia. The average balance sheet total is found by dividing the total assets of these companies by the total number of companies by the author. More detailed information, how many entities in Estonia would meet the micro-entity criteria set in Accounting Directive 2013/34/EU is not available. The number of companies includes companies that had 1-9 employees at the end of the financial year. See also http://pub.stat.ee/px-web.2001/Dialog/Saveshow.asp.

[7] The calculation is made by the author based on the number of companies (55,458) in Estonia that may be in line with the micro entity definition which is multiplied with the accounting burden proposed by the European Commission (1,169 euros).

for a small country like Estonia, the author believes that these calculations are very subjective in nature and the actual "savings" could be much lower.

Those against differential reporting have pointed out the following two important cons: 1) the creation and adoption of a new accounting standard for SMEs is costly and takes time, and 2) the comparability and reliability of financial statements may suffer.

The European Commission proposal does not include any reference to research that would analyse the potential implementation and upkeep costs of different sets of accounting standards for SMEs (or micro-entities) among Member States. This is also pointed out by Wallace and Wortmann (2003), who argue that the creation and adoption of a new accounting standard that would be generally accepted among practitioners, users, and regulators is a daunting proposition. The time and costs associated with this ambition could be better spent educating the public about the profession, supporting existing systems, and effecting change from within. Developing a new set of standards will create a situation where practitioners will suffer from "standards overload". Accountants will need to be versed in both "Big GAAP" and "Little GAAP" in the event that an interested party, such as a lending institution, requires that the alternate GAAP be applied to the financial statements. The dual GAAPs also represent additional costs to practitioners in the areas of continuing education, authoritative resources, and quality control systems. This raises the question of whether firms will have to breakout staff between those that are trained in "Big GAAP" and those trained in "Little GAAP". (Wallace and Wortmann, 2003)

Collis and Jarvis (2003) argue that regulators, particularly governments, have focused on the costs associated with financial statements and have tended to ignore the benefits. An example of this is the statutory audit in the UK. In many countries, the audit has been seen primarily by a number of governments as an undue burden on small businesses due to the cost. Any benefits derived from the audit have been disregarded. This has resulted in legislation exempting small businesses from a statutory audit (Collis and Jarvis, 2000) and the proposal to exempt small companies (including micro-entities) from statutory audit was also included in the European Commission proposal to change accounting Directives Four and Seven (European Commission, October 25, 2011).

However, research in the UK indicates that there are a number of benefits and it is recognised that a large proportion of owner-managers of small companies would continue to have their financial statements audited even if there was no legal requirement to do so. These small companies clearly recognise that the benefits of the audit exceed the costs (Collis and Jarvis, 2000). Thus, this unbalanced approach to regulation could result in the introduction of new regulations that may have a negative impact on the small business community.

When talking about the pros and cons of differential reporting, most of the arguments are directly or indirectly linked to the needs of users. But no consensus exists among researchers whether users of financial statements of different-sized entities have different needs or not.

Paterson (2001) and Sayther (2004) argue that small companies and large companies have different audiences. Some information presented under "Big GAAP" may be irrelevant to the stakeholders of small businesses, and the cost of producing this irrelevant information may preclude the production and presentation of more relevant data (Rennie and Senkow, 2009). Also, proponents of differential accounting expect that users of financial statements of listed companies have higher knowledge than users of financial statements of smaller companies. Thus, from the understandability principle, the financial statements prepared by smaller entities should present information simpler. The empirical evidence shows that many ordinary users (*unsophisticated users*) like simplified financial statements. For example, people who have a limited knowledge of financial reporting (e.g. employees) experience considerable confusion about the financial accounting concepts and technical terms. There are also difficulties interpreting the income statement and balance sheet, and understanding the difference between cash and accrual accounting. (Hussey and Everitt, 1991)

Rennie and Senkow (2009) identified lenders and owners as the primary financial statement users among private companies in Canada. They also note that lenders, a primary user of private company financial statements, have often expressed support for requiring one set of GAAP for all businesses regardless of size or type (Rennie and Senkow, 2009). Other studies argue the opposite and show that bankers either routinely use financial statements that are not in conformity with GAAP or do not use at least some of the information required by GAAP (Maingot and Zeghal, 2006). But the IASB does not agree with defining managers as primary users of financial statements of SMEs. Owner-managers use SMEs' financial statements for many purposes. However, it is not the purpose of the *IFRS for SMEs* to provide information to owner-managers to help them make management decisions. Managers can obtain whatever information they need to run their business. (IASB, 2009b)

Some authors believe that the EU initiative to create simplified accounting rules to SMEs could bring long-term benefit to European businesses, as it will give national authorities flexibility to have a robust public debate about the creation of revised financial reporting standards tailored to the needs of the smallest businesses. But the author of the current dissertation would like to ask why do we need the same regulation among micro-entities in the EU when micro-entities are in most cases engaged in business at the local level with no or limited cross-border activity? One could argue that for entities that conduct their operations within their local environment it makes sense to set their requirements at the national level not at the EU level. It is therefore recommended by Schiebel (2008) that an in-depth research should be initiated to determine to what extent the needs of owner-managers and other users of SME financial statements differ between larger versus the smallest SMEs, and to what extent they may differ within the EU. It may be the case that the needs of the smallest SMEs are best served by a system developed by national regulators, taking into account their specific economic environment.

Much of the research on differential reporting has ignored the cultural differences. For example, research focusing on the perceptions of small business managers in Singapore and Australia found culture-based differences in disclosure preferences of small business entities (Williams and Tower, 1998). This may be an important consideration for international organizations, including the European Commission, when attempting to establish uniform regulations for SMEs. Or even, it may be a task better suitable for national standard setters who have a better insight into specific local conditions of SMEs not seeking internationalization.

In focusing on the Estonian SMEs, one may not find a complex separation of management and owners. Among small companies with few owners, the owners are managers in most cases, and the company may also have few employees. They may even be one-man companies with a simple organizational structure. The question will rise: why should small companies comply with demanding regulatory requirements? Some authors believe that they should not. Bunea, Săcărin and Minu (2012) conducted a research among expert accountants in Romania and found that the current regulations do not provide for a reasonable level of simplification for the small and medium-sized enterprises and, consequently, a more simplified reporting system is needed for the SMEs based on the quantitative criteria of a particular SME (turnover, average number of employees, total assets). But Lungu, Caraiani and Dascalu (2007) argue that it is the practitioners and academics, who are pushing for differential reporting rather than SME owners and users, who may not even be aware of the pros and cons.

On balance, the arguments for differential reporting seem to be stronger. Indeed, countries are increasingly adopting the differential reporting requirements (refer to Chapter 3.5.2). Therefore, it needs to be decided what should be differentiated. This could include accounting, auditing, disclosure and filing requirements as well as enforcement. Distinctions can also be made between requirements for individual company financial statements and group financial statements. Therefore, differential reporting goes well beyond differentiating generally accepted accounting principles between large and small companies. (Eierle, 2005)

Concerning the differentiation of accounting standards, one needs to decide whether differentiation should be restricted to disclosure or should also affect recognition and measurement. Usually, relaxations regarding disclosure are more generally accepted than differentiation of recognition and measurement principles, since the latter directly impact on the reported profit figure, reduce comparability between enterprises, and may increase the risk of misinterpretation by financial statement users (Eierle, 2005). On the other hand, differentiation of recognition and measurement principles may be necessary to significantly reduce the burden resulting from the financial reporting regime and/or to better tailor financial reporting requirements to users' needs (Walton & Harvey, 1996, referred in Eierle, 2005).

Cost/benefit considerations are not only used to justify modifications of accounting standards, but also to differentiate audit requirements (such as the legal obligation to have an annual statutory audit, qualification requirements for persons entitled to carry out statutory audits, quality assurance requirements, provisions to ensure auditors' independence, etc.). Further differentiation can be made with respect to filing requirements, for example, with respect to the amount of information that needs to be filed (full versus abbreviated financial statements, complete exemption from filing financial statements). Additionally, institutional enforcement procedures can be differentiated, for example: enforcement can be restricted to specific types of enterprises (e.g. public interest entities); investigation procedures can distinguish between entities (e.g. active versus reactive enforcement approach); and sanctions (e.g. for late filing) can vary between different categories of enterprises (Eierle, 2005). The author has further analysed the current legislation in the European Union in Chapter 3.5.2 to find out what kind of differentiation rules have been created by member states to minimize the administrative burden of SMEs.

As can be seen from the above, based on cost/benefit considerations there are advantages as well as disadvantages to differentiating financial reporting requirements between entities. However, due to a lack of unambiguous empirical evidence on the needs of financial statement users for different categories of entities or the costs incurred by preparers, it is usually not possible to precisely quantitatively determine the costs and benefits associated with differentiating financial reporting requirements (McCahey & Ramsay, 1989, referred in Eierle, 2005). Even if all individual preferences for accounting regulations and their differentiation could be precisely identified, due to users' heterogeneous needs it is usually impossible to establish a differential reporting framework that is Pareto optimal. Thus, decisions on what kind of relaxations should be granted to which categories of entities primarily depend on subjective cost/benefit judgments and are therefore in the end very often a political choice (Ordelheide, 1998; Mould & Boczko, 2002; Wagenhofer & Ewert, 2002, referred in Eierle, 2005). It follows that differential reporting frameworks are the result of conventions, which are in turn strongly influenced by the socio-economic environment, as well as prevailing political objectives, priorities and convictions. Thus, differential reporting models are ultimately "social constructs", which reflect the society in which they have been developed. (Eierle, 2005)

To conclude, the analysis above about differential reporting shows that this is an important topic that should also be considered in Estonia when modifying the existing or developing a new accounting framework for Estonian enterprises. Whether the differentiation should be based on qualitative or quantitative criteria and modify accounting standards, auditing or disclosure and filing requirements has to be decided taking into account the country specific factors.

3.3. Barriers Faced by Small and Medium-Sized Entities in Realizing the Benefits of Accounting Standards

SMEs are a critical part of the European economy and have a central role to play in growth and job creation, but their use of standards and their involvement with standardisation is typically low. Both SMEs and the economy more widely could benefit from SMEs being more involved in the standardisation world, and external support and encouragement is needed to overcome the barriers that exist. (European Commission, 2012)

SMEs may face a sequence of barriers, each of which may hinder them from benefiting from becoming involved in the process of standardisation (i.e. the development of standards). SMEs may be aware of standards but not realise that they can actively participate and influence the development process. This problem has two sides: low awareness amongst SMEs and employees, and a failure to create awareness through appropriate and sufficient communication activities. Once SMEs are aware of the fact that they can become actively involved in standardisation, they may not be aware of the importance of participation or its potential benefits. (European Commission, 2012)

SMEs may also find it difficult to assess whether involvement would be worth the investment. Once SMEs are aware and interested in the development of standards, they may face problems in tracing relevant standards development projects. The barriers here elate to the way that information is offered, and the ability of SME employees to trace relevant standards projects. An important reason for non-participation and not becoming involved in standardisation is simply being unaware of the standardisation process. Lack of resources (money, time, skills and knowledge) is another reason, where the costs of participation in terms of the time required, travel expenses and membership fees can be proportionally higher for SMEs. Because SMEs are often not sufficiently represented in the standardisation process, standards can be found to be ill-adapted to SMEs' needs. The specific interests of SMEs risk not being properly taken into account in the resulting standards, which they only learn about after their publication. (European Commission, 2012)

Being involved does not necessarily imply effective involvement. Other participants may ignore an SME simply because it is an SME, or issues presented by a multinational may carry more weight, consciously or unconsciously. Research shows that the role of individuals in standardisation can be decisive, but this may be determined by the skills and knowledge of the particular representatives and their preparedness for active, effective participation. Involvement in standardisation is a long-term investment and SMEs need to be able to evaluate this investment. Cost precedes benefits, and yet a continuous focus on benefits is needed during the process to justify involvement. SMEs may be unable to evaluate the effectiveness of their involvement, or ignore this important step, which may result in decreasing company support over time and sub-optimal priority being given to participation in standards development. (European Commission, 2012)

Also, innovative SMEs may want to initiate new standardisation activity, because they need standards to make an invention a market success. However, SMEs may not understand how to go about this process, or have the time and resources to lead the initiation of new work. (European Commission, 2012)

A study conducted by Praxis among Estonian SMEsrevealed that although the majority of SMEs find that the general burdensome legislation and excessive bureaucracy are a problem, the more specific factors arising from the legal environment and procedural rules are no hindrance for most enterprises (Praxis, 2012). Unfortunately, this study does not explain in full detail, which legislation is considered to be burdensome and whether it also includes accounting. In an interview conducted by the author with the Chairman of the Estonian Accounting Standard Board Ago Vilu in April 2012 revealed that when the EASB was developing new accounting standards based on the IFRS for SMEs that were adopted on December 30, 2011 and came effective starting from January 1, 2013 (early adoption was allowed), then only approximately 10 companies sent their comment letters to the EASB to make proposals on which accounting principles should be allowed and how they should be applied (Vilu, 2012). Therefore, the author believes that the issue, whether Estonian SMEs face any barriers when participating in accounting standard-setting process needs further investigation. This is why the author of the current dissertation has included some questions about this issue in the survey conducted among Estonian SMEs (see Chapter 4). The author aims to find out, whether Estonian SMEs have submitted to the Estonian Accounting Standards Board's proposals to change accounting principles in Estonia and if they have not done that, what the main reasons hindering them from participating in the standards setting process are.

3.4. Users and Uses of Financial Statements of Small and Medium-Sized Entities

Although the questions “Who are the users of financial statements?” and “Are the users of financial statements of listed and non-listed companies different?” have been empirically investigated, the author believes that the empirical research conducted so far focuses largely on developed countries (Mirshekary and Saudagaran, 2005) or listed or public companies. The main approach in the majority of the empirical research is to predefine the main user groups and concentrate on a various specific problems related to the needs of these users.

Most studies focus on listed or public companies and predetermine the investigated users groups, i.e. shareholders and investors (Clark-Murphy and Soutar, 2004; Al-Ajmi, 2009; Pricewaterhouse-Coopers, 2007), financial analysts (Chandra, 1974; Arnold and Moizer, 1984; Firer and Meth, 1986; Vergoossen, 1993; Barker, 1998; PricewaterhouseCoopers, 2007), bankers (Stanga ja Tiller, 1983) and accountants (Chandra, 1974). Other researchers include the above mentioned financial statement users into their investigation and also take into account auditors, tax officers and academics (Abu-Nassar and Rutherford, 1996; Mirshekary and Saudagaran, 2005). Some studies concentrate on a specific problem about users' information needs, for example, whether financial analysts prefer current cost information or should additional information about price level changes be disclosed in the financial statements (Etes 1968; Brenner 1970). Other researchers take a wider approach and analyse the information sources of users.

There is little research, whose aim to identify the "real users" of the annual reports and their information needs without predefining any user groups or information source. Also, not many researchers concentrate specifically on SMEs as they rather investigate the differences of users and their needs between listed and non-listed, or public and non-public companies. These terms, however, may vary quite significantly from what is meant by SMEs in this dissertation. But size is an important determinant for accounting differentiation. The author believes that the empirical studies conducted so far still leave a considerable gap of ignorance about the influence of an entity's size on the attitudes of its financial statement users. The aim of this sub-chapter is to review the previous studies on SMEs as the author believes that there is a need to determine specifically the needs of users of SME financial statements.

This is also supported by the views of the IASB. When comparing the definition of users and their needs in the *Framework* (2010) and in the *IFRS for SMEs* (2009a) we can see that they are slightly different. The IASB (2009b) explains that users of financial statements of SMEs may have less interest in some information in general purpose financial statements prepared in accordance with the "Big IFRSs" than users of financial statements of entities whose securities are registered for trading in public securities markets or have public accountability. For example, users of the financial statements of SMEs may have greater interest in short-term cash flows, liquidity, balance sheet strength and interest coverage, and in the historical trends of profit or loss and interest coverage, than they do in information that is intended to assist in making forecasts of an entity's long-term cash flows, profit or loss, and value. However, users of financial statements of SMEs may need some information that is not ordinarily presented in the financial statements of listed entities. For example, as an alternative to the public capital markets, SMEs often obtain capital from shareholders, directors and suppliers, and shareholders and directors often pledge personal assets so that the SMEs can obtain bank financing.

With that the IASB recognises that the needs of users of the "Big IFRS" are different from the needs of the financial statement users of the *IFRS for SMEs.* The difference in users' needs has also been recognised by many other researchers (Collis, Dugdale and Jarvis, 2001; Flower, 2004b; Evans, Gebhardt, Hoogendorn, Marton, Di Pietra, Mora, Thinggard, and Vehmanen, 2005; Roberts and Sian, 2006; Sian and Roberts, 2009). Therefore, the author believes it is necessary to concentrate on the needs of the financial statement users of SMEs. That will be done in the following literature review.

This sub-chapter is divided into three main parts. Firstly, the author would like to give an overview of users of SME financial statements as defined in the previous empirical research. Knowledge about SME financial statement users is essential to make decisions regarding the regulation of the field. Secondly, the author would like to outline the main information needs of users of SME financial statements using also previously conducted studies. Financial statements can be viewed as the final products of the financial reporting process. As in other areas, it is not practicable to "produce" before there exists an understanding about the users' needs. And thirdly, the author would like to give an overview of the criticism raised in the accounting literature about the misperceptions by the users of financial statements and the negligence about their information needs.

Although the author aimed to review the previous literature about the financial statement users and uses from the viewpoint of SMEs as defined in this dissertation, it soon became quite obvious that the prior research does not follow the same criteria when defining SMEs. This is due to the fact that the studies under investigation have been conducted at different times (from the early 2000s to the present) and in different countries depending heavily on the national legislation (i.e. the local definition of SMEs) and on the information available about non-public/private/SME companies. In addition, one must be careful when comparing these studies as there is no definitive list of companies that qualify as "small" or "medium" at any moment in time. Moreover, size is a dynamic concept that changes over time and studies must be interpreted in the context of the thresholds in force at the time and the way in which the researchers have chosen to define size (Collis, 2008). Therefore, in the following analysis the author has deviated from the definition of SME as specified in the Accounting Directive and has used the general term of SMEs that includes "non-public" or "private" or just "smaller" enterprises in Chapters 3.4.1 and 3.4.2.

3.4.1. Users of Financial Statements of Small and Medium-Sized Entities

In the accounting literature from the beginning of the 20th century, business managers were considered to be the primary users of accounting information. Later on, when the decision-usefulness concept of users of financial statements became more important, the focuses shifted to determine the "real users" of financial statements. But a review by Jarvis (1996) in the United Kingdom confirms that little is known about either the users or the uses of the statutory financial statements of small companies. The main research studies that have been conducted to date have concentrated on bank lenders, directors and auditors of smaller companies. For example, qualitative research by Berry, Crum and Waring (1993) attempted to assess the actual processes used by banks in evaluating corporate loan applications by enterprises that included a large proportion of small businesses (Collis, Dugdale and Jarvis, 2001). Also, Kirsch and Meth (2007) argue that smaller SMEs are usually managed by their owners and because of that for these smaller entities bank financing is of major importance. Therefore, for these entities banks (and other lenders) are among the main user groups of SME financial statements.

In its consultative document, the Consultative Committee of Accountancy Bodies (the CCAB) working paper in the UK took a wider approach and expressed the opinion that "in the case of small entities, the important users are the managers, employees, lenders and trade creditors" (CCAB, 1994) (Collis, Dugdale and Jarvis, 2001). But according to Di Pietra, Evans, Chevy, Cisi, Eierle and Jarvis (2008) empirical studies from Germany show that the main purposes of financial statements of SMEs are:

- a basis for taxation;
- providing information for banks;
- determining dividend payments;
- providing information for investors; and
- providing information for management.

The author believes it is appropriate to allocate the investors and management into three distinctive groups: owners involved in the management of the entity (owner-managers), hired management and other executives (management and directors) and non-participating owners (non-controlling owners). The latter group also includes in the opinion of the author, the investors, who operate for the purpose to earn profits. When the owner-managers can be classified as an internal user group of SME financial statements than non-controlling owners have diverse needs as the external stakeholders of SMEs. Owner-managers and management and directors are often viewed as the same interested parties in case of SMEs, and therefore, the author has decided to address the specific needs of these user groups in Chapter 3.4.2 as one.

Providing information for customers, suppliers, employees or potential investors is, by contrast, for most SMEs of minor importance (Ernst and Young, 2005; Oehler, 2005; Eierle *et al.*, 2007; Kajüter *et al.*, 2007; referred through Di Pietra *et al.*, 2008). This is supported with the research by Sian and Roberts (2009) in the UK, who conclude that although other studies have suggested that small enterprise owners often read the reports of competitors, customers or suppliers, there is little evidence that they actually send their own reports to customers or suppliers, with only 4% of entities under examination claiming to do this.

On the contrary, the survey conducted in the UK by Collis (2008) shows that more than half of the directors (56%) considered that the published accounts are useful to users. The main user groups are considered to be suppliers and other trade creditors (64%), credit rating agencies (62%), competitors (57%) and the banks/lenders (46%). Also, the results by Cole *et al*. (2012) suggest that the users of non-listed companies ought to be suppliers (26%), customers (24%), consultants (21%) and competitors (19%). Cole *et al*. (2012) also believe that these types of users are, however, neglected in the accounting research and by the standard setters. Moreover, since standard setters view shareholders and analysts as the most important users, it seems logical that they adapt the financial statements to their needs. The IASB claims that since investors are providers of risk capital, financial statements that meet their needs will also meet most of the general financial information needs of other users. The focus on investors could, however, make the financial statements less useful for the other user groups. Indeed, viewing certain user groups as more important than others could result in a self-fulfilling prophecy as the financial statements are adapted to the needs of these specific user groups. This development can be strengthened if the neglected user groups are not in a position to demand extra reliable information. Therefore, more empirical research is necessary concerning the needs of the different types of users to explore whether this assumption is true. (Cole *et al*. 2012)

As seen in Table 3, the common belief is that bankers and management are seen as the most important user group of smaller entities. But some authors have pointed out the real users of financial statements and their needs may vary from country to country due to differences in the economic environment. For example, Deaconu, Popa, Buiga and Fülöp (2008) pointed out that in an emerging market as Romania the interest rates are very high and owners are the main source of financing. Therefore, they are also seen as the main users of financial statements. In light of that the author believes it is important to investigate the financing structure of Estonian smaller companies as well (loan versus equity) to further understand the potential users of SME financial statements, because as we see in the following chapters, the information needs of owners versus bankers may differ.

Very comprehensive research about the accounting legislation and environment surrounding small enterprises is conducted by European Commission in November, 2008. In that study, the members of expert group gave an overview of the possible financial statement users of small enterprises, their information needs and the accounting legislation in force in different EU countries that took into account the specific needs of small enterprises. Unfortunately, the study did not specify the methods used to collect the information and because of that the results in respect of users and their information needs seemed subjective in nature (i.e. they were the opinions of the members of the expert group). Also, information about Estonia was not included in that report. Therefore, the author has investigated this aspect herself.

In Estonia no empirical research has been conducted previously in respect of SME financial statement users. Although some authors have analysed whether the *IFRS for SMEs* would be suitable for SME financial statement users (Heinsaar, 2010) or the possible ways to improve the Estonian SME's financial reporting system (Hirvoja-Tamm, 2010), these authors have not empirically analysed the users of SME financial statements in Estonia. Nevertheless, both authors make suggestions about, who the SME financial statement users might be in Estonia. Heinsaar (2010) believes that Estonian SME financial statements are particularly interesting for banks, creditors, owners, managers, credit rating agencies, key customers, suppliers and competitors.

Table 3. Users of SME financial statements

Users of SME financial statements	Collis, Dugdale and Jarvis (2001) [8]	AICPA (2004) [9]	Di Pietra *et al.* (2008)	Collis (2008) [10]	Collis (2008) [11]	EC (2008)	Sian and Roberts (2009)	IASB (2009b)	Cole *et al.* (2012)
Internal									
- Owner-managers						X	X		
- Management and directors	X	X	X	X		X			
- Employees				X		X			
External									
- Banks and other lenders	X	X	X	X	X	X	X	X	
- Potential investors and non-controlling owners			X			X		X	
- Trade creditors and suppliers	X	X		X	X	X		X	X
- Customers	X					X		X	X
- Competitors				X					X

[8] The author of the thesis has included the top four of the users pointed out by Collis, Dugdale and Jarvis (2001). The top users of SME financial statements were bank managers (mentioned by 84% of respondents), directors or management (74%), major lenders (23%, interpreted as trade creditors) and major customers (23%).

[9] The author of the thesis has only included the opinions of owner/managers of companies whose revenue is less than 5 million US dollars per year (interpreted as a smaller company or SME). It includes the top three of the users for whom the owner/managers believe the company prepares financial statements.

[10] Collis (2008) divided the users of SME financial statements into two groups: users, who receive financial statements directly from the company, and users, who do not receive them directly from the company, but are still considered to use the published financial statements of the company. This column represents the users, who receive financial statements directly from the company.

[11] By Collis (2008), this column represents the users, who are considered to use the published financial statements of the company. Refer also to footnote 10.

- Consultant									X
- Tax authority			X	X			X		
- Credit rating agency					X			X	
- Industry regulators				X					
- Government agencies						X			

Source: composed by the author

Hirvoja-Tamm (2010) on the other hand believes that in Estonia, the most interested parties of SME financial statements are banks (although they have rights to demand additional information if necessary), financial and trade creditors, non-conducting owners (in some cases also conducting owners), potential investors and important clients. Both Heinsaar (2010) and Hirvoja-Tamm (2010) exclude Estonian Tax and Customs Board and Statistics Estonia from the direct user group of SME financial statements as the specific needs of these governmental agencies require appropriate reports. Whether this exclusion is correct will be analysed in the empirical part of this dissertation.

To conclude, we can see in Table 3 that the understanding about the financial statement users of SMEs varies quite significantly. Whether this is influenced by country specific factors (developed versus developing country), cultural aspects (see Gray, 1988) or legal framework (code law versus common law) is hard to say. Probably all the factors play a role when defining the users and uses of SME financial statements. Therefore, the author believes firmly that further research in this area is necessary, including in Estonia.

3.4.2. Uses of Financial Statements of Small and Medium-Sized Entities

According to the *IFRS for SMEs* (2009a) the objective of financial statements of a small or medium-sized entity is to provide information about the financial position, performance and cash flows of the entity that is useful for economic decision-making by a broad range of users who are not in a position to demand reports tailored to meet their particular information needs. Financial statements also show the results of the stewardship of management – the accountability of management for the resources entrusted to it. The author of this dissertation would also like to point out that the IASB's *IFRS for SMEs* does not include any implications to equity theories, i.e. from whose standpoint the financial statements should be prepared, although the IASB's *Framework* (2010) clearly stated that financial reporting should be prepared from the perspective of the entity. It is, similarly to the Framework, oriented to a rational user who needs information to make economic and useful decision about the financial position, performance and cash flows of the entity. Therefore, one can argue, that the *IFRS for SMEs* takes a normative approach in defining the users and their information needs.

The author believes that the objective of the *IFRS for SMEs* is quite general and does not specify the needs of specific users, including what purpose the financial statements of SMEs should fulfil, which sources of information or reports are perceived as the most important ones, etc. Therefore, the author believes that further research in this area is necessary.

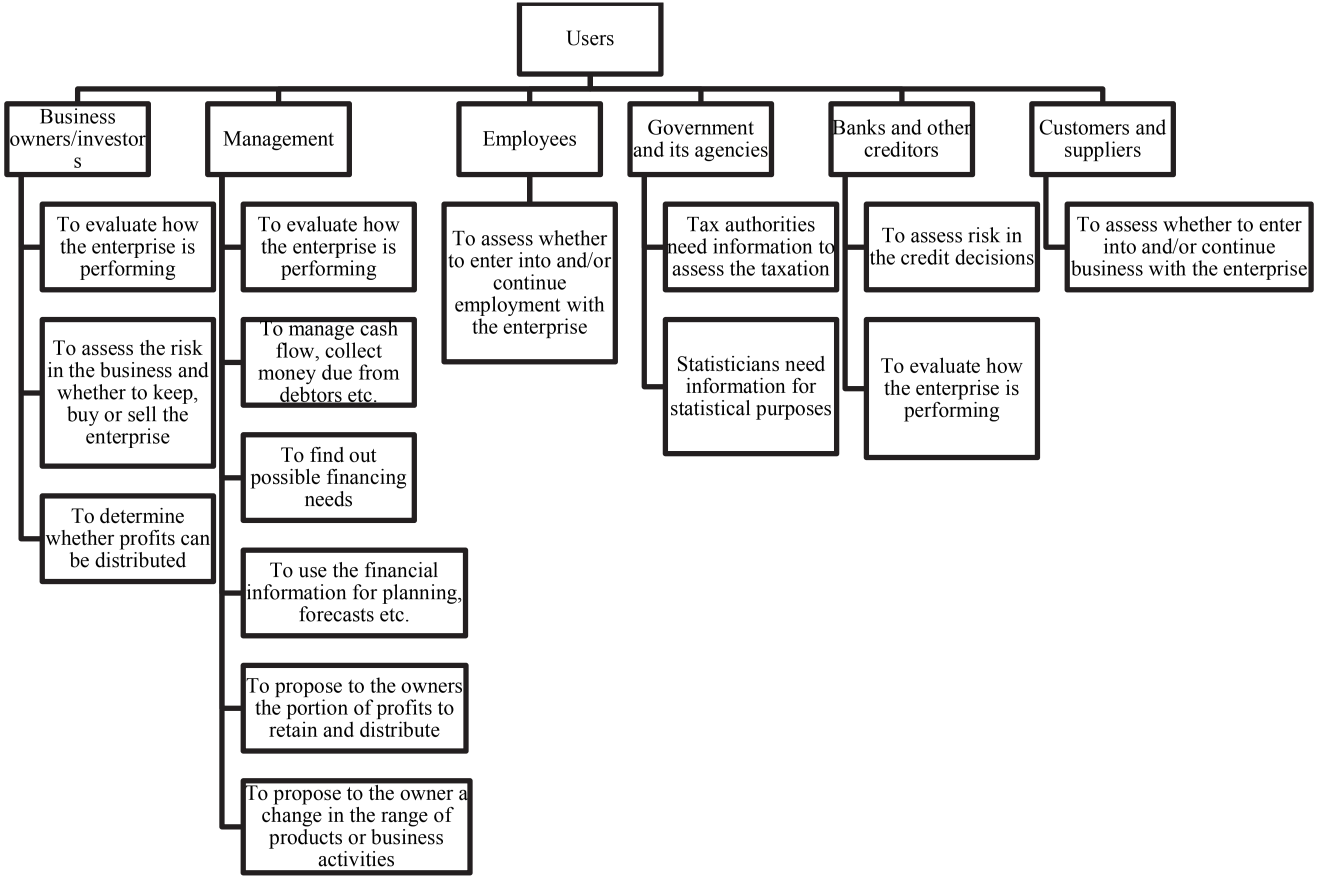

Figure 4. Needs of different user groups of SME financial statements
Source: composed by the author based on the European Commission (2008)

According to the study conducted by the European Commission in November 2008, the needs of different user groups can be summarized as shown in Figure 4. The model proposed by the European Commission about the users and uses of financial statements takes a position of enterprise theory as the financial statements seem to be prepared for a wider range of audience not only including owners and creditors, but also the government and its agencies (i.e. society as a whole).

To fulfill these needs, users expect to receive information from the financial statements of SMEs or from other sources. Based on the research by Cole *et al*. (2012) users of non-listed companies are most interested in the income statement and balance sheet, where they usually review the following indicators: turnover evolution, net profit, operational profit, (composition of) equity, and degree of debt. Cole *et al*. (2012) also conclude that the sequence of these indicators may differ among internal users (shareholders) and external users (suppliers, customers, consultants and competitors) although the top 5 indicators are the same for both user groups. It is also important to note that users of non-listed companies are least interested in segment information, notes to pensions, information about the shares, corporate governance and accounting policies of stocks (Cole *et al*., 2012). The author of this dissertation believes that the lack of interest in segment information can be explained by the fact that many SMEs do not operate in several fields of activity or outside their home country. Many of the SMEs are owner-managed and may not have transactions that would require disclosure of distinct transactions such as pensions, acquisition of own shares etc. According to the IASB (2009b) the users of financial statements of SMEs may have a greater interest in short-term cash flows, liquidity, balance sheet strength and interest coverage, and in the historical trends of profit or loss and interest coverage. However, the users of financial statements of SMEs may need some information that is not ordinarily presented in the financial statements of listed entities. For example, as an alternative to the public capital markets, SMEs often obtain capital from shareholders, directors and suppliers, and shareholders and directors often pledge personal assets so that the SMEs can obtain bank financing. (IASB, 2009b)

According to European Financial Reporting Advisory Group (EFRAG) (2008) and the IASB (2009b) the interest of external users of SME financial statements can be summarised as shown in Figure 5.

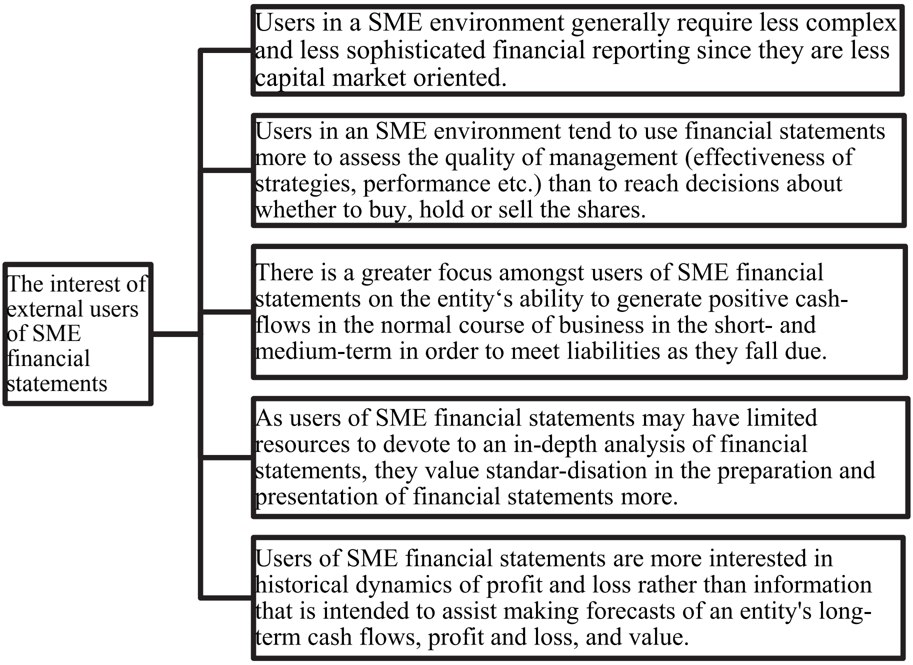

Figure 5. Interest of external users of SME financial statements
Source: composed by the author based on the EFRAG (2008) and the IASB (2009b)

According to Table 3, the most important user groups of SME financial statements ought to be management and directors and bankers. Therefore, the specific needs of these user groups are under comprehensive analysis. As explained in Chapter 3.4.1, the specific needs of owner-managers and management and directors are addressed as one.

Collis, Dugdale and Jarvis (2001) concluded that 51% of directors of small companies and 68% of medium-sized companies claim to read the statutory accounts of their major competitors; 44% of small companies and 62% of medium-sized companies claim to read those of their major customers; and 26% of small companies and 36% of medium-sized companies claim to read the annual report and accounts of their major suppliers. The respondents (i.e. directors of SMEs) were also asked to indicate how useful they found certain sources of information for managing the company. For small companies, the three most useful sources of information for management purposes are, in the order of importance, the management accounts for the period, the annual report and accounts and cash flow information. For medium-sized companies it is the management accounts, cash flow information and budgets respectively. According to a survey conducted by Sian and Roberts (2009) among internal users, the most common useful information resources were bank statements (54%) and annual reports (37%). The least useful information was found to be published industry data and production reports (Sian and Roberts, 2009). Published industry data and information from credit rating agencies were the least important for all companies (Collis *et al.*, 2001).

Based on the prior literature review another important user group of SME financial statements is bankers and other lenders. According to Berry, Grant and Jarvis (2004) the importance of bank lending as the major source of small business finance has been widely recognized (Binks and Ennew, 1996; Binks *et al.*, 1992a; Berry *et al.*, 1993; Cosh *et al.*, 1996; Cruickshank, 2000; ESRC Centre for Business Research, 2000; Keasey and Watson, 1994, referred through Berry, Grant and Jarvis, 2004). The results of their survey conducted among European banks that were active in lending to UK SMEs showed that 4 out of 10 banks under investigation adopted a going concern approach to lending. This means that when making an initial decision to lend the bankers were most interested in the business environment, future cash flows and the income statement for repayment analysis, sensitivity analysis for assessing risks, and the past and current financial position for testing forecasts. For monitoring the activities of SMEs who had received the loan management accounts and working capital trends were important (Berry *et al.*, 2004).

Zülch and Burghardt (2008) analysed granting of loans by banks to small and medium-sized entities in Germany. It was found that the annual financial statements were the most important sources of information for lending decisions. However, "planning data/budgeting", economic assessments and tax balance sheets also play an important role. A further aspect under consideration was the importance of an auditor's report. The result shows that it is significant for the majority of credit institutions: 55% were "mostly" or "always" in agreement with this statement, a further 37% "sometimes" agreed. Thus it can be concluded that the creditability of information politics can in some cases be increased by an auditor's report. Apart from the quantitative parameters in the decision process, there are also qualitative aspects which the participants consider to be significant, such as "planning", "location, future potential" and "securities", to name but a few. Furthermore, it could be demonstrated that for small and medium sized entities in Germany, the bank internal rating can be a motivation to change the system of financial reporting from national to international standards. (Zülch and Burghardt, 2008)

Prior research has also discussed the possible differences when banks' deal with smaller companies. It has been confirmed that the financial statements are used for decision-making regardless of the size of the company. However, compared to large companies, banks use the information contained in the financial statements of small businesses in different ways and with different emphasis on depending on several internal and external factors. According to Berry, Faulkner, Hughes and Jarvis (1993) there are some differences in the evaluation of loan applications of small companies and these are summarized in Figure 6.

Specifications for assessing loan applications of small business

Detailed ratio analyses and estimates are used less for small businesses.
Sales results may be adjusted on a subjective basis, as actual results are better than the ones reported.
The financial indicators used in the assessment of loan application for small businesses differ from the ones used for assessing larger organizations. For example, in the case of small businesses, higher leverage is more acceptable compared to large businesses, because many small businesses are under-capitalized.
General levels of liquidity do not apply to small businesses, because the latter are forced to use a lot of short-term credit.
Weaker financial ratios are more accepted in case of small businesses as this will be compensated by other indicators. For example, when the profit margins are questionable, greater importance is assigned to the size of financial guarantee and leverage.
In case of a small business, banks rely less on financial forecasts. A possible reason for that is the close relationship with the bank, which allows the bank to get a perception of the vitality of the company in other ways. Forecasts are needed only when a new customer comes to the bank or an existing company is experiencing difficulties or having changes made.

Figure 6. Specifications for assessing loan applications of small businesses
Source: Berry *et al*. (1993) (referred through Heinsaar, 2010, 32 and translated from Estonian into English by the author)

Banks' loan requests for information may be different from country to country due to the traditions related to financing. Berry *et al*. (1993) note, for example, that the organization of British and the U.S. banking is very different and therefore, the results of the survey carried out in one country cannot be extended to another country. Most of the research about bankers needs has been carried out in the UK and according to Berry *et al.* (2004) there are differences between Britain and the rest of the European banks. Unfortunately, the rest of the banks have not been studied in such depth as needed. The majority of this work has been related to German banks (Binks *et al*., 1992; Deeg, 1998; Mullineux, 1994, refferred in Berry, Grant and Jarvis, 2004). This work identifies a number of issues around the structure of German banking, different governance systems and a service-based rather than price-based competitive environment, as having direct impact on lending. The common differences that rise are: closer bank/customer relationships based upon sharing of information, longer terms for loans and the acceptance of lesser forms of security than those traditionally acceptable in the UK. Apart from the literature concerning banking practice in Germany the remainder of the literature is very thin and in parts contradictory. For example Binks *et al*. (1992) cite the work of Bannock and Doran (1991) which suggests that typically bankers in Spain, Portugal and Finland claim that their lending is secured while bankers in the UK, Denmark and Germany claim that most lending is unsecured. Anson *et al*. (1995) on the other hand, suggest that less emphasis is placed on security and loan covenants by Spanish banks than is the case in the UK.

(Berry *et al.* 2004). Therefore, some should be cautious when making generalizations about the needs of bankers who are involved with making lending decisions in respect of SMEs as these may differ significantly. This is yet another support for the fact that the needs of bankers (and other user groups of SME financial statements) should be investigated in Estonia.

In Estonia, limited empirical research has been conducted in respect of for what purposes SME financial statement users exploit the information and what kind of information is valued by them. There have been some general studies among SMEs conducted by Saar Poll (2005; 2008) and Praxis (2012), but these studies have not explored the issues of financial reporting among SMEs in depth. The master thesis compiled by Heinsaar (2010) and Hirvoja-Tamm (2010) did not set the aim to investigate the real users and uses of SME financial statements in Estonia.

To conclude the prior overview shows that the uses of financial statements of SMEs among the users differ and therefore, it is essential to find out the users preferences in order to make grounded decisions in respect of future accounting and reporting rules. Although it may not be possible to satisfy the needs of all the user groups, in-depth research may give a better overview of common elements of interest of different user groups. After we can find out the intersection of uses of SME financial statements, it is possible to make recommendations about legislative changes that would meet the needs of the users of SME financial statements.

3.4.3. Criticism about Prior Research Regarding Small and Medium-Sized Entities

When talking about the needs of users from the decision-usefulness perspective as emphasized by the IASB in both the *Conceptual Framework* and in the *IFRS for SMEs*, the criticism raised against it cannot be overlooked. Most contemporary accounting textbooks contain similar statements and declare the supremacy of user needs and user decisions (often referred to as decision usefulness) as a guide in the construction of external financial statements. According to Young (2006) connections between financial statement users, decision usefulness and standard-setting were forged relatively recently and were initially controversial. More than 60% of the respondents to the FASB's (1974) discussion memorandum on the objectives of financial reporting opposed adopting the provision of information for economic decision making as an objective for accounting. Although ASOBAT (1966) outlined the decisions of various external users – to invest or not, to extend credit or not, to remain employed by the company or not, to alter the existing government policy, etc., the study admitted that: "Ideally more should be known about what does and should affect users' decisions." The Study Group Report (1973) was even blunter in admitting its lack of knowledge "users' needs for information are not known with any degree of certainty. No study has been able to identify precisely the specific role financial statements play in the economic decision-making process". Today, the IASB, the FASB and other participants in the standard-setting process have constructed (and continue to construct) a very specific and quite limited image of the financial statement user – a rational economic decision-maker. In stressing the "rational", users can be seen more as hypothetical readers of financial statements rather than actual readers. Hypothetical, because we can presume that they behave in particular ways (otherwise they are irrational) and that they are therefore interested in only particular types of information. (Young, 2006)

The limited conception of the financial statement users necessitates an equally narrow conception for the purpose of accounting reports. The rational economic decision maker that is the current focus of standard setting is primarily concerned with economic events and transactions and with predicting their impacts upon an entity's future cash flows, future profitability and future financial position. Meaningful, significant and useful information are defined only with respect to their supposed utility in forming such predictions and expectations. Other types of information that might be construed as meaningful, significant or useful under an alternative construction of the financial statement user can be easily dismissed as falling outside the "appropriate" purview of financial statements. Consequently, the attention of the standard-setting organization remains firmly fixed on economic events and transactions particularly those that are quantifiable. (Young, 2006)

Standard setters have understood the importance to analyse the real needs of users and have made efforts to overcome this deficiency by trying to raise users' direct involvement in the actual standard setting process. For example, in 2002 the FASB interviewed the users of financial statements. The IASB has invited users to participate in its working groups. However, the study results suggest that participation in the standards-making process by users is still very low. Jorissen, Lybaert, Orens and van der Tas (2013) for example find that users provided on average only 2.7% of the comment letters during the period 1995 to 2001[12] and 1.1% of the comment letters during the period 2001 to 2007. They classify investors, financial analysts, consumer organizations, or other parties who use financial information for decision making purposes, as users. Users engage in formal participation and the unbalance between preparers and users' participation in the IASB's work has got even worse over time, since users write significantly fewer comment letters per document issued by the standard setter after the reform.

Collis, Dugdale and Jarvis (2001) stress that their research provides evidence to suggest that in relaxing the regulation of financial reporting by smaller entities, the emphasis should not be on reducing compliance costs, but on ensuring that changes in accounting regulation lead to accounts that are more useful to users. Creation of increasingly complex (accounting) institutions increases the need for a central

[12] The longitudinal analysis begins in 1995, when it became clear that the IASC would become a major player in the development of international accounting standards with a view toward worldwide acceptance. In 2001, the reform of the international accounting standard setter was undertaken to enhance its mission as a global standard setter. For the analysis, we have chosen an equal time frame before and after the reform of the standard setter. Since a period of 6 years elapsed between 1995 and the reform, we also include a period of 6 years after the reform.

authority to enforce increasing complex rules and contracts (North, 1981). However, expanded central authority allows influential players to bend the accounting system in their own favour leading to inefficient contracting and degradation of markets (Wysocki, 2011). Therefore, it is important to find a balance between the benefits of institutions and the costs of the necessary central control. Taking into account the recent developments in relation to accounting legislation on the EU level these ideas should really be borne in mind as it seems that the focus at the EU level has really drifted to reducing costs or the administrative burden rather than taking into account the needs of real users.

When speaking about the limitations of previous studies about the users and uses of SME financial statements, the author believes that they have concentrated too much on internal users. Collis (2008) believes that the views of the directors are vital because they are the main users of the statutory accounts (Page, 1984; Carsberg, Page, Sindall and Waring, 1985; Barker and Noonan, 1996), which they use for a range of internal and external purposes (Collis and Jarvis, 2000). Furthermore, the directors are responsible for evaluating the costs and benefits of the financial reporting options available and choosing the strategy that best meets the company's needs (Collis, 2008). But, Collis (2008) also admits that there are limitations to her survey, namely, consultation is needed with other stakeholders, such as small accountancy practices providing services to SMEs, lenders, creditors and users of the published financial statements. This is also emphasized by Cole *et al*. (2012) who state that suppliers, competitors, consultants and customers are more common users than expected and represent a large part of the frequent users. These types of users are, however, neglected in the accounting research and by the standard setters. Moreover, since standard setters view shareholders and analysts as the most important users, it seems logical that they adapt the financial statements to their needs. The IASB claims that since investors are providers of risk capital, financial statements that meet their needs will also meet most of the general financial information needs of other users. The focus on investors could, however, make the financial statements less useful for the other user groups. Indeed, viewing certain user groups as more important than others could result in a self-fulfilling prophecy as the financial statements are adapted to the needs of these specific user groups. This development can be strengthened if the neglected user groups are not in a position to demand extra reliable information. More empirical research is necessary concerning the needs of the different types of users to explore whether this assumption is true. (Cole *et al*., 2012)

When speaking about the sample selection of previous studies, Cole *et al*. (2012) believe that a limitation of their study is that their sample relies on self-selection of respondents and consists of mainly Belgian users. They also could not obtain information concerning the response rates and some types of users could be over- or underrepresented. Their respondents might, therefore, not fully represent the underlying population. They did not take into account the fact that one user can be more influential than another user either. The results should, therefore, be interpreted with care. On the other hand, their sample is relatively large and diverse. So far, only few studies questioned more than 500 real users. Therefore, the survey offers interesting insights into the users of financial statements of non-listed companies and their information needs. (Cole *et al*., 2012).

Another limitation pointed out by Sian and Roberts (2009) concludes that the majority of SME respondents were found not to be particularly financially aware with few having any training in accountancy or business management, this being reiterated by the accountants who were questioned. This implies that any accounting guidelines produced for SMEs must be simple and easy to understand, because for some anything of a technical nature will be considered difficult (Sian and Roberts, 2009).

Taking into account the criticism pointed out by other researchers, the author believes that a research gap definitely exists in respect of users and uses of SME financial statements. First of all, the future research should not only bear in mind the decision-usefulness aspect, but should examine what the reports, financial ratios or other indicators are that users bear in when making decisions about entities. Secondly, the future research should investigate not only management and bankers as the main user group, but also take into account other user groups identified in prior research. The author also admits that there are some limitations that would be hard to overcome. Firstly, when trying to investigate all the user groups of SME financial statements, self-selection seems to be the best option to identify the potential users and their function as suppliers, customers, employees etc. But self-selection may lead to over- or underrepresentation of some user groups and would make it hard to take into account the fact that one user can be more influential than another user. Secondly, previous studies conducted among SMEs have struggled with low response rates. The reasons for low response rates can only be assumed – whether it is because of the wrong targeting of main user groups (i.e. the sample) or about the ignorance or incompetence of SME financial statements users. The study conducted by the author tries to overcome some of the limitations of the previous research or at least bear these in mind when conducting her own research in Chapter 4.

3.5. Changes in Legislation at International Level affecting Small and Medium-Sized Entities

In June 2013, the IASB developed guidance to help micro-sized entities apply the IFRS for SMEs. The reason for that was that over 80 jurisdictions have either adopted the IFRS for SMEs or stated a plan to do so within the next few years. In some of these jurisdictions the IFRS for SMEs is being used by very small companies with just a few employees. The IASB was asked and agreed to develop guidance suitable for micro-sized entities currently applying the IFRS for SMEs and also those considering doing so in the future. The guidance has been developed with input from the SME Implementation Group. It extracts from the IFRS for SMEs only those requirements that are likely to be necessary for a typical micro-sized entity, without modifying any of the principles for recognising and measuring assets, liabilities, income and expenses. In a few areas, it also contains further guidance and illustrative examples to help a micro-sized entity to apply the principles in the IFRS for SMEs. (IASB homepage). The guidance contains cross-references to the IFRS for SMEs for matters not covered by the guidance. Consequently, having applied the guidance, an entity's notes to the financial statements and auditor's report could refer to conformity with the IFRS for SMEs because this guidance does not modify the requirements of the IFRS for SMEs. (IASB homepage)

Contrary to EU legislation, the guide published by the IASB to help micro-sized entities in applying the IFRS for SMEs does not define a micro entity in quantitative terms. A jurisdiction may choose to define a micro entity in quantitative terms or provide further indicators of typical characteristics in order to indicate when this guide should be used in that jurisdiction. A micro entity is normally a very small entity with simple transactions that has the following typical characteristics (IASB, June 2013):

- few employees and often owner-managed;
- low or moderate levels of revenue and gross assets; and
- does not:
    - have investments in subsidiaries, associates or joint ventures;
    - hold or issue complex financial instruments; and
    - issue shares or share options to employees or other parties in exchange for goods or services.

The guide extracts requirements from the IFRS for SMEs without modifying any of the principles for recognising and measuring assets, liabilities, income, and expenses, and without changing any of the presentation or disclosure requirements. The guide includes only those requirements of the IFRS for SMEs that are likely to be necessary for a typical micro entity. If an entity encounters a transaction in the current period or any comparative period presented in the financial statements (or that occurred in an earlier period but still affects those periods) that is not dealt with in this Guide, the entity is required, by the guide, to refer to the applicable requirements in the IFRS for SMEs. (IASB, June 2013)

In 2013, the American Institute of Certified Public Accountants (AICPA) issued its Financial Reporting Framework (FRF) for Small- and Medium-Sized Entities. The FRF for SMEs accounting framework is designed for America's small business community. It delivers financial statements that provide useful, relevant information in a simplified, consistent, cost-effective way. The FRF for SMEs may be the ideal accounting basis for owner-managers and users who need financial statements that are prepared in a consistent and reliable manner in accordance with a framework that has undergone professional and public scrutiny. (AICPA, 2013)

A standard definition of "small- and medium-sized entities" does not exist in the United States. However, the term is intuitive, widely recognized, and effectively descriptive of the scope of entities for which the FRF for SMEs accounting framework is intended. The task force and staff deliberately did not develop quantified size criteria for determining SME because they decided that developing quantified size tests is not feasible and not an effective way of describing the kinds of entities for which the framework is intended. (AICPA, 2013)

This list presents certain characteristics of typical entities that may utilize the FRF for SMEs accounting framework. These characteristics are not all-inclusive and not presented as a list of required characteristics the entity must possess in order to utilize it (AICPA, 2013):

- The entity does not have regulatory reporting requirements that essentially require it to use GAAP-based financial statements.
- A majority of the owners and management of the entity have no intention of going public.
- The entity is for-profit.
- The entity may be owner-managed, which is a closely held company in which the people who own a controlling ownership interest in the entity are substantially the same set of people who run the company.
- Management and owners of the entity rely on a set of financial statements to confirm their assessments of performance, cash flows, and of what they own and what they owe.
- The entity does not have significant foreign operations.
- Key users of the entity's financial statements have direct access to the entity's management.
- Users of the entity's financial statements may have greater interest in cash flows, liquidity, statement of financial position strength, and interest coverage.
- The entity's financial statements support applications for bank financing when the banker does not base a lending decision solely on the financial statements but also on available collateral or other evaluation mechanisms not directly related to the financial statements.

According to the FASB (2012) the AICPA's development of a special purpose financial reporting framework is compiled for privately held micro entities. That would include the 5 million plus entities that have 50 or fewer employees. It is anticipated that the special purpose framework document will be between 200-250 pages. The framework is intended to be static and only change every 3-4 years. Procedures performed on financial statements prepared using the framework will also probably be limited to compilations and reviews and constituents who will use the AICPA framework primarily will be tax preparers. Therefore, the framework prepared by AICPA is not fully compatible with the IFRS for SMEs or the European Union Accounting Directive.

To conclude, the recent outreach activities and guidance issued by international players show that EU's "think small first" principle has widespread around the world and everyone seems to be interested in developing new standards suitable for the smallest of companies. Therefore, the author believes that this again proves the actuality of the topic and the need to determine the proper accounting framework for Estonian SMEs.

3.6. Legislation in the European Union and at the International Level Affecting the Financial Reporting of Small and Medium-Sized Entities

According to Strouhal, Dvorakova and Pasekova (2011) SMEs have fewer resources to use on influencing financial standards and the financial reporting system is arguably less responsive to their needs. Whilst the due process of international financial reporting standards is admittedly a transparent procedure, it is one in which only those players with major financial and intellectual resources can participate (Burlaud *et al* 2011). The tightening of professional accounting standards and extensive and complex accounting pronouncements governing financial reporting have added complexities to the preparation of financial statements and have further exacerbated their financial reporting problem (Strouhal *et al* 2011). The need to establish appropriate accounting standards for SMEs has created many debates around the world, but currently, there is no consensus achieved on the recommended solutions as the views of different interested parties (IASB, EU) vary significantly.

For more than thirty years the European Union has been very active in the field of financial reporting. Its aim has been to "harmonize" the accounts of enterprises, that is, to reduce the differences between the member states in this area (Flower, 2004a, 98). According to Nobes and Parker (2004), the harmonization process should be viewed as increasing the comparability of practices in different countries by establishing limits of variation. There are three reasons why the European Union aims for harmonization – they relate to the common market, to the protection of shareholders and to the competition (Flower, 2004a, 98). As the recent financial crisis had a severe impact on many of the smallest companies in the EU economy it is, therefore, essential to free up micro enterprises to allow them pursue their business goals without unnecessary regulation. The European Commission is aware that the smallest firms face the greatest costs in complying with regulations. Compliance with legislation stemming from the regional, national or European level will always be more burdensome for the smaller enterprise. (European Commission, November 23, 2011)

The European Union has sought to achieve the harmonization of the enterprises by enacting directives. A directive is addressed to the governments of the member states and it requires them to modify their national laws so as to bring into effect the directive's provisions on their territory (Flower, 2004a, 101). The currently applicable European Union law on financial reporting is based exclusively on directives, of which one is particularly important from the perspective of this dissertation – 2013/34/EU. On June 26, 2013 the European Parliament and the Council also adopted the new accounting Directive 2013/34/EU on the annual financial statements, consolidated financial statements and related reports of certain types of undertakings, amending Directive 2006/43/EC of the European Parliament and of the Council and repealing Council Directives 78/660/EEC and 83/349/EEC (European Parliament, 2013, June 26). However, the Fourth Directive was drafted primarily for quoted companies, apparently, and either absentmindedly or through osmosis came to be extended to all companies (Bailey *et al.* 2001, 1479). This Directive is the result of the EU's vision for simplifying EU rules on company law, accounting and auditing with the stated aim of reducing administrative costs for EU businesses.

The aim of this sub-chapter is therefore to analyse the accounting legislation effective in the European Union and in its member states to find out what opportunities have been created for SMEs for preparing and presenting their annual financial statements. This sub-chapter also incorporates proposals made and guidance adopted by other international organisations taking into account the needs of SMEs.

3.6.1. Legislation Adopted by the European Union Affecting Small and Medium-Sized Entities

In order to simplify the requirements for SMEs the European Commission in 2007 actively started a review process of the Accounting Directives with the "think small first" as the guiding principle. Although the simplification project for SMEs coincides with the publication of the IASB's Exposure draft of a proposed IFRS for SMEs, the European Commission, however, did not believe that the IASB work on SME accounting would provide sufficient elements to simplify the life of European SMEs. (European Commission, July 10, 2007)

Instead, the Commission identified a number of other measures that could lead to tangible simplification for SMEs. The first measure in this context is to exempt "micro-entities" from the application of the accounting directives. For these smallest enterprises the burden related to the establishment of the annual accounts is particularly heavy. At the same time there is a lack of broad demand for their financial statements. With an exemption in the accounting directives, it would be left to Member States to determine which rules micro-entities should be required to comply with. (European Commission, July 10, 2007)

In February 2009, the European Commission also started public consultation on the review of the Accounting Directives. Its aim was to gauge the opinion of European stakeholders on several proposals to modernise and simplify the 30-year-old Accounting Directives. Research was conducted to receive responses and commentary on different issues and questions. Most respondents expressed their support for simplification of accounting for small and medium-sized companies. One question in the research was "Do you think that current rules for small, medium and large companies are appropriate?" Users and public authorities were most satisfied with the current rules, whilst preparers were most dissatisfied. Some respondents based their negative opinion on the fact that currently there was no micro entities category in the Fourth Directive. There were also comments that current rules were not appropriate for owner-managed companies. Rules were considered too complex and burdensome especially for small companies (the notes to the accounts were perceived as particularly onerous) and there were several requests for a more thorough overhaul than that proposed in the consultation paper. Respondents criticised the high number of Member State options, as well as the reluctance of some Member States to use simplification options. (European Commission, October 2009)

When examining the various policy options available to replace the old Accounting Directives, the Commission considered adopting the IFRS for SMEs at the EU level and at the end of 2009 the Commission started a public consultation on the respective standard. The Commission decided to seek the opinion of European Union stakeholders on this standard. Supporters of the widespread use of the IFRS for SMEs in Europe argued that the Standard is best suited for large and medium-sized companies, for international groups and subsidiaries of companies reporting under the full IFRS as well as for companies active internationally, listed on non-regulated markets, seeking foreign financing or "non-publicly accountable" (as defined in the IFRS for SMEs). The countries who thought that the IFRS for SMEs is suitable for widespread use within Europe included Estonia, United Kingdom, Czech Republic, Denmark, Netherlands, Poland, Cyprus etc. (European Commission, May 2010).

Those opposed to the IFRS for SMEs highlighted its complexity for SMEs, especially as regards the smallest companies. Rather than reducing administrative burdens, they argued that the Standard would increase them, and increase the cost of preparation and audit of individual company accounts. The extensive disclosure requirements were also seen as potentially creating a competitive disadvantage vis-à-vis companies that follow less stringent rules. Opponents also questioned the actual benefits that the Standard could bring to companies operating only locally and having a limited number of shareholders. The countries oppose to the use of the IFRS for SMEs included Germany, France, Italy, Belgium, Finland etc. (European Commission, May 2010)

In March 2010, EFRAG[13] also conducted a study and concluded that few requirements of the IFRS for SMEs were incompatible with the EU Directives – for example, the prohibition to present items of income and expenses as extraordinary, financial instruments measurement at fair value, the presumptive useful life of 10 years for goodwill, prohibition to reverse an impairment loss recognized for goodwill etc. (Girbina *et al* 2012)

[13] After the IASB has published a standard or an amendment to a standard, or the IFRS Interpretations Committee has published an interpretation, the European Commission requests endorsement advice from EFRAG. Additionally, the European Commission requests an effects study on the pronouncement under consideration for endorsement. During the process EFRAG holds a number of consultations with interest groups and finally issues the advice to European Commission concerning whether the standard meets the criteria for endorsement for use in the European Union.

As the IFRS for SMEs was assessed to be incompatible with the European Accounting Directives, in October 2011 the European Commission decided not to endorse the IFRS for SMEs to European Union legislation. The European Commission rejected the option to adopt the IFRS for SMEs at EU level as the Commission deemed that the IFRS for SMEs did not meet the objective of reducing the administrative burden. Nevertheless, EU Member States are able to permit or require the IFRS for SMEs as their accounting standard for all or some of their unlisted companies provided that the Directive is fully implemented and the standard, which is partially in conflict with the Accounting Directive, is modified to comply with any accounting requirement of the Directive that departs from the IFRS for SMEs. (European Commission, June 12, 2013)

After rejecting the IFRS for SMEs, the European Commission proposed a new Directive to replace and modernize the existing Accounting Directives 78/660/EEC and 83/349/EEC. The proposal was aimed to simplify the accounting requirements for small companies and improve the clarity and comparability of companies' financial statements within the Union. These policy choices reduce the amount of information available to users of small and medium-sized company financial statements, including information which is publicly available. (European Commission, October 25, 2011)

The proposal introduced a specific regime for small companies that will considerably reduce the administrative burden currently borne by small companies when they prepare their financial statements. It will limit disclosures by way of notes which will be limited to only five key areas to the accounts: (1) accounting policies; (2) guarantees, commitments, contingencies and arrangements that are not recognised in the balance sheet; (3) post-balance sheet events not recognised in the balance sheet; (4) long-term and secured debts; and (5) related party transactions. Maximum harmonisation will ensure that companies of the same size benefit from a level playing field across the EU. Also, there will be no requirement for a statutory audit for small companies and small groups will be exempt from preparing consolidated financial statements. (European Commission, October 25, 2011)

To this end, the proposal seeks to reduce the number of options currently available to Member States, insofar as these options are detrimental to the comparability of the financial statements. General principles such as "substance over form" will become mandatory so as to increase the clarity of financial statements. For example, the proposed Directive proposes only one balance sheet layout (see Article 9), whereas previously the Member States could choose between two different layouts, and Article 11 also excludes the "last in, first out", (LIFO) method of valuation as a permitted valuation method for stocks and fungible items. (European Commission, October 25, 2011)

The proposal for a new accounting Directive did not contain any new policy proposal regarding micro companies as these were assessed separately with a proposal of the Commission in February 2009. This project was finalized on March 14, 2012 when the European Parliament and the Council adopted a directive aimed at exempting very small companies from accounting and financial reporting obligations. The new provisions have the potential to significantly reduce the administrative burden for those companies not exceeding the limits of two of the following criteria (European Parliament, 2012, March 14):

- a balance sheet amount of 350,000 euros;
- a net turnover of 700,000 euros; and
- an average of ten employees during the financial year.

The directive will allow Member States to permit micro-entities to draw up only an abridged balance sheet and income statement. Also, Member States may exempt companies from different obligations related to the presentation, disclosure and publication of financial statements (European Parliament, 2012, March 14). Financials statements of micro-entities drawn up in accordance with the new directive shall be regarded as giving the true and fair view required by Article 2(3) of 4th Directive, and consequently Article 2(4) and (5) shall not apply to such accounts. (European Parliament, 2012, March 14). These optional exemptions will still be compatible with national obligations to keep records showing the company's business transactions and financial situation.

On June 26, 2013 the European Parliament and the Council adopted the new accounting Directive 2013/34/EU amending Directive 2006/43/EC of the European Parliament and of the Council and repealing Council Directives 78/660/EEC and 83/349/EEC (European Parliament, 2013, June 26). The process to prepare a new accounting directive already started in 2007, when the European Commission published a Communication setting out its vision for simplifying EU rules on company law, accounting and auditing with the stated aim of reducing administrative costs for EU businesses. After a consultative process lasting several years, this resulted in a new single Accounting Directive. (FEE, January 2014)

When Member States transpose the Directive into their national legislation they must decide how to implement the many Member State options that are available to them. There are over 90 base options available and many of these allow the Member State to “require” or “permit” the option in question, thereby allowing further choice. Although the European Commission does not anticipate that Member States will experience any problems in meeting the transposition deadline, it is implementing several supporting measures in order to facilitate this transposition, including transposition workshops. (FEE, January 2014)

The provisions within the 2013 Directive will first apply to financial statements for financial years commencing on or after the 1st of January 2016. The undertakings (i.e. entities) affected by the 2013 Directive include public and private limited liability companies and also unlimited companies and partnerships (limited or otherwise) where all the members have limited liability. Not for profit organisations are excluded. The 2013 Directive provides, for the first time, a full list of all legal forms of undertakings covered by the Directive detailed by each EU Member State. (FEE, January 2014)

The 2013 Directive is a re-cast of the 4th and 7th Directives rather than a complete conceptual rewrite. Consequently, many of the provisions and, indeed, text in the 2013 Directives has been carried over from the 4th and 7th Directive. The new Directive follows a more structured approach to the layout of the Articles, not least arising from the amalgamation of two Directives into one and a small reduction in the number of options available to Member States. The new Directive is based on a "bottom-up" approach in that it starts with the requirements for small undertakings first and then adds additional accounting and reporting requirements as undertakings pass the thresholds for medium and large undertakings. It also contains new size thresholds for micro (technically, this was included in the 4th Directive but only via an amendment thereto made in March 2012), small, medium and large undertakings that not only impacts on their accounting and reporting requirements but also on the requirement to prepare consolidated financial statements and to have an audit. (FEE, January 2014)

The new Accounting Directive also formalises eight fundamental accounting principles (with some Member State options). Items presented in the financial statements must be recognised and measured in accordance with the following principles: going concern, consistency and comparability, prudence, materiality, accrual basis for accounting, substance over form and measuring items in accordance with the principle of purchase price or production cost (FEE, January 2014). It also states some basic rules for accounting, such as that the opening balance sheet for each financial year shall correspond to the preceding closing balance sheet and the components of assets and liabilities shall be valued separately. It prohibits any set-off between assets and liabilities, or between income and expenditure items. (FEE, January 2014)

However, there are Member State options in respect to certain of these principles (FEE, January 2014):

- Set-off: may be permitted on the face of the financial statements but the gross amounts must then be disclosed in the notes;
- Substance over form: may be dis-applied;
- Materiality: may be restricted to presentation and disclosure only;
- Prudence: may permit or require the recognition of all foreseeable liabilities and potential losses in respect of a financial year, if these only became apparent between the end of the financial year and the date on which the balance sheet is drawn up.

Currently, Estonian accounting legislation follows 10 basic principles for preparing annual accounts. The comparison of the principles allowed by new accounting Directive and Estonian Accounting Act are included in Table 4.

Table 4. Comparison of accounting principles allowed by Accounting Directive 2013/34/EU and Estonian Accounting Act

Accounting principles	Accounting Directive 2013/34/EU	Estonian Accounting Act
Business entity	Not included	The accounting entity keeps separate accounts of its assets, liabilities and business transactions and the assets, liabilities and business transactions of its owners, creditors, employees, customers and other persons.
Going concern	Included	Included
Understandability	Not included	The information disclosed in financial statements shall be concise and unambiguous to users of the statement who have sufficient financial knowledge to understand the statement.
Materiality	Included - The principle of materiality should govern recognition, measurement, presentation, disclosure and consolidation in financial statements. According to the principle of materiality, information that is considered immaterial may be, for instance, aggregated in the financial statements. However, while a single item might be considered to be immaterial, immaterial items of a similar nature might be considered material when taken as a whole. Member States should be allowed to limit the mandatory application of the principle of materiality to presentation and disclosure.	Included - financial statements shall set out all material information that affects the financial position, economic performance and cash flows of the accounting entity. Information in financial statements is considered material if failure to disclose the information could influence the business decisions made by the users of the statements on the basis thereof. Immaterial items may be accounted for and recorded in the financial statements using a simplified method
Consistency and comparability	Included - accounting policies and measurement bases shall be applied consistently from one financial year to the next.	Included - the same accounting policies, presentation formats and financial statement formats are used on an on-going basis in preparation of financial statements.
Matching principle	Not included	Expenses relating to the revenue earned during a given accounting period are deducted from such revenue. Costs incurred during an accounting period other than the period in which they benefit the accounting entity shall be recorded as expenses during the period in which they benefit the entity.
Objectivity	Not included	Information presented in financial statements shall be objective and reliable.

Conservatism / prudence	Included (prudence)	Included (conservatism) – financial statements shall be prepared on a prudent and cautious basis in order to avoid overestimation of assets or revenue or underestimation of liabilities or expenses. At the same time, it is prohibited intentionally to understate assets or revenue, overstate liabilities or expenses, or create reserves hidden from the users of the statements.
Disclosure	Annual financial statements should be prepared on a prudent basis and should give a true and fair view of an undertaking's assets and liabilities, financial position and profit or loss. It is possible that, in exceptional cases, a financial statement does not give such a true and fair view where provisions of this Directive are applied. In such cases, the undertaking should depart from such provisions in order to give a true and fair view.	Financial statements shall disclose all the information necessary to present a true and fair view of the financial position, economic performance and cash flows of the accounting entity.
Substance over form	Included - the presentation of items in financial statements should have regard to the economic reality or commercial substance of the underlying transaction or arrangement. Member States should, however, be allowed to exempt undertakings from applying that principle.	Included - business transactions are recorded in accounts and financial statements based on their substance even if this does not correspond to their legal form.

Source: composed by the author based on Accounting Directive 2013/34/EU and EAA

Based on Table 4 it is obvious that many of the basic principles applied in the preparation of annual accounts in Estonia are not included in the accounting Directive. Also, differences in interpretation exist between some principles. For example, the Directive allows departure from the general principles of the true and fair view in exceptional cases. At the same time, Member States are permitted to define these exceptional cases and lay down special rules for this purpose. Together, these two amendments can easily be interpreted in a way that unfortunately reduces the adherence to the principle of the true and fair view in the preparation of financial statements (FEE April 23, 2012). The true and fair view is one of the most prominent and globally recognised accounting concept. Together with the substance over form principle, it requires the company to provide reliable financial information truly reflecting the underlying economic reality of the transactions, not only their legal form. This principle is aimed at achieving compliance with all the other accounting principles. All the accounting requirements should be subordinated to this principle and none should directly or indirectly prevent true and fair presentation.

Financial Statements must comprise a balance sheet, income statement and selected notes to the financial statements. Member States have the option to require medium sized and large undertakings to include other statements, such as a cash flow statement or statement of other comprehensive income (FEE, January 2014). When comparing the requirements with the current Estonian accounting legislation, we can see that in Estonia, all accounting entities are required to present the balance sheet, income statement, cash flow statement and statement of changes in equity. According to the new rules, the latter two would not be an option for small entities (including micros) any more.

Some of the more important changes and Member State options in respect of balance sheet items are listed below (FEE, January 2014):

- There have been changes to the treatment of goodwill which is to be amortised over a minimum of 5 years to a maximum of its useful economic life. If the useful economic life cannot be determined then it must be written-off over a period selected of between 5 and 10 years by the Member States;
- The treatment of other intangible assets now generally follows that of goodwill;
- There is a Member State option to permit or require the related costs of borrowing to be added to the cost of fixed and current assets;
- Subscribed unpaid share capital must be treated as an asset, either shown separately or under the heading of Debtors.

Some of the more important changes and Member State options in respect of income statement items are listed below (FEE, January 2014):

- The permitted layouts for the income statement have been reduced from four options to two. The options permitting the presentation of "Charges" before "Income" have been deleted;

- Undertakings are permitted to provide more detail than required on the face of the income statement and Member States have the options to require additional information or for headings to be combined. Member States are also permitted to restrict deviations from the standard formats as far as necessary to facilitate electronic filing;
- There is no heading for extraordinary items in the standard formats (but undertakings can add additional lines and Member States can permit or require additional lines). The 2013 Directive requires disclosure of exceptional items in the notes for medium-sized and large undertakings.

Member States have no option in defining the size criteria for *micro-undertakings* but have the option whether or not to grant any or all of the following accounting simplifications (FEE, January 2014):

- To prepare an abridged balance sheet;
- To prepare an abridged income statement;
- No obligation to prepare notes to the financial statements nor a management report;
- To use of "Cash +" accounting - the accruals basis is used only for revenue, raw materials\consumables, staff costs, value adjustments to assets and taxation;
- Not permitted to use fair value accounting;
- Required to publish only an abridged balance sheet.

Investment and financial holding undertakings are excluded from these simplifications. In other respects, micro-undertakings are treated as small undertakings. Micro-undertakings must still maintain accounting records in accordance with national requirements.

Member States have the option to apply some, all or none of the following simplifications for *small-undertakings* (FEE, January 2014):

- To prepare an abridged balance sheet;
- To prepare an abridged income statement (starting with "Gross profit or loss");
- To prepare notes to the financial statements that only cover:
    - Accounting policies;
    - Revaluations and value adjustments to assets at fair value;
    - Financial commitments;
    - Exceptional items;
    - Amounts owed falling due after more than 5 years;
    - Average number of employees;
    - Credit transactions and commitments relating to members of the managerial body;
- To exempt the preparation of a management report or to permit the preparation of an abridged management report (excluding non-financial key performance indicators);

- To exempt the publication of an income statement and management report.

Medium-sized undertakings must fulfil all the requirements relating to small undertakings and then also disclose present and disclose additional information. In respect of the additional information, Member States have the option to apply some, all or none of the following simplifications (FEE, January 2014):

- To prepare an abridged income statement (starting with "Gross profit or loss");
- To prepare an abridged management report (excluding non-financial key performance indicators);
- To publish abridged balance sheet; and
- To publish abridged notes to the financial statements. These include all the notes required for small entities plus:
    - Movements in fixed assets;
    - Adjustments to assets arising from tax legislation;
    - Directors' emoluments etc.;
    - Analysis of staffing costs;
    - Details of interests in associates, subsidiaries etc.;
    - Deferred tax provisions and movements;
    - Shares subscribed for (including by class and warrants, if appropriate);
    - Any undertaking of which it is a member with unlimited liability;
    - Ultimate controlling party and location where consolidated accounts are available;
    - Proposed appropriation of profit or loss;
    - Off-balance sheet arrangements;
    - Unadjusted post-balance sheet events;
    - Transactions with related parties (Member State option to restrict these only to transactions not concluded under normal market conditions).

There is a Member State option to require medium-sized undertakings to provide disclosures in the financial statement in addition to those specified in the 2013 Directive.

In Table 5 the requirements regarding the balance sheet are summarized in respect of micro- and small-sized undertakings. Medium-sized entities are not included in this analysis as they are not allowed to prepare an abridged balance sheet and they have to disclose all items listed in Annex IV (vertical balance sheet) of Accounting Directive 2013/34/EU, but they are allowed to publish an abridged balance sheet.

Table 5. Balance sheet (vertical layout) requirements for micro- and small-sized undertakings according to Accounting Directive 2013/34/EU

	Micro	Small
A. Subscribed capital unpaid of which there has been called	X	X
B. Formation expenses	X	X
C. Fixed assets	X	X I. Intangible assets II. Tangible assets III. Financial assets
D. Current assets	X	X I. Stocks II. Debtors III. Investments IV. Cash at bank and in hand
E. Prepayments and accrued income	X*	X**
F. Creditors: amounts becoming due and payable within one year	X	X
G. Net current assets/liabilities	X	X***
H. Total assets less current liabilities	X	X
I. Creditors: amounts becoming due and payable after more than one year	X	X
J. Provisions	X	X
K. Accruals and deferred income	X*	X**
L. Capital and reserves	X	X I. Subscribed capital II. Share premium account III. Revaluation reserve IV. Reserves V. Profit or loss brought forward VI. Profit or loss for the financial year

* Unless Member States option to dispense with this has been chosen
** Unless national law provides that such items are to be shown under D (II) for "Prepayments and accrued income" and under F or I or both for "Accruals and deferred income"
***Taking into account "Prepayments and accrued income" when shown under E and "Accruals and deferred income" when shown under K.)
Source: composed by the author based on Accounting Directive 2013/34/EU

When comparing the current balance sheet format applicable for accounting entities in Estonia, one can see many differences. But the main question is, whether Estonia is able to keep their current balance sheet format or not? The Accounting Directive does not give a single answer. Article 10 states that "For the presentation of the balance sheet, Member States shall prescribe one or both of the layouts set out in Annexes III and IV", but Article 11 specifies that "Member States may permit or require undertakings, or certain classes of undertaking, to present items on the basis of a distinction between current and non-current items in a different layout from that set out in Annexes III and IV, provided that the information given is at least equivalent to that otherwise to be provided in accordance with Annexes III and IV". So first, the Directive obliges Member States to use the balance sheet layouts of the directive and then allows the Member States to implement other schemes than stated in the Directive. So, the current wording of the Directive allows Member States to introduce various schemes to different businesses.

In Table 6 the requirements regarding the preparation of the income statement are summarized in respect of micro-, small- and medium-sized undertakings. In respect of publication, small-undertakings may be exempted from the publication of an income statement, but medium-sized undertakings are not.

Table 6. Income statement requirements (by nature) for micro-, small- and medium-sized undertakings according to Accounting Directive 2013/34/EU

	Micro-undertakings	**Small- and medium-sized undertakings**
Net turnover	X	X*
Variation in stocks of finished goods and in work in progress.	N/A	X*
Work performed by the undertaking for its own purposes and capitalised	N/A	X*
Other operating income	X	X*
Cost of raw materials and consumables	X	X*
Staff costs	X	X
Value adjustments	X	X
Other operating expenses	N/A	X
Other charges (income from participating interest, interest income/expense, value adjustments)	X	X
Tax on profit loss	X	X
Profit or loss for financial year	X	X

* items 1 to 5 may be combined under one item called "Gross profit or loss"
Source: composed by the author based on Accounting Directive 2013/34/EU

Kajasalu (2014), who has performed a more thorough comparison of the Estonian accounting legislation and the new EU Accounting Directive, points out, when translating relevant EU legislation to national legislation (Estonian) one should monitor the consistent use of common terminology. The same content on different definitions of terms is confusing and difficult to understand. The bottleneck of the Directive is a lack of definitions of the key concepts. While there are some concepts defined in the Directive, many of the key terms are left undefined. The uncertainty about the content of the terms covered by the Directive makes the interpretation of the requirements of the Directive by the Member States arbitrary and hence may reduce the comparability of financial statements.

According to Kajasalu (2014) the following provisions in the Estonian legislation require coordination with the Accounting Directive:

- to create a legal basis for the terms: “micro”, “small”, “medium” and “large” undertaking;
- to create a legal basis for the terms: “small”, “medium” and “large” group;
- to introduce a new “bottom-up” approach and impose rules according to company size;
- to improve the contents of the prudence concept;
- to coordinate the balance-sheet layout;
- to coordinate the income statement layouts;
- to exempt small groups from the requirement to prepare consolidated financial statements;
- terminology as a whole may need to be updated.

The 2013 Directive does not include any specific references to the IFRS for SMEs, because of the Commission’s previously stated position that the IFRS for SMEs would not serve the objectives of simplification and the reduction of administrative burden for SMEs in the EU. There is no specific prohibition for Member States permitting or demanding that the IFRS for SMEs be used by small- and medium-sized companies, but the 2013 Directive still has two areas of incompatibility with the IFRS for SME. One of the areas of incompatibility is the treatment of the amortisation period for goodwill where the expected useful life cannot be estimated – the IFRS for SMEs demands a 10 year amortisation period and under the 2013 Directive a Member State has the option to choose an amortisation period between 5 and 10 years. Thus, depending on the Member State’s decision, this incompatibility may or may not be an issue. (FEE, January 2014)

The other incompatibility relates to the treatment of unpaid subscribed share capital, which the 2013 Directive requires be carried as an asset but which the IFRS for SMEs requires to be offset against equity. Obviously, this is only an issue for undertakings finding themselves in this situation. The IASB has not removed this incompatibility in their latest exposure draft of the standard published in October 2013. (FEE, January 2014)

All 28 EU Member States must transpose the new Accounting Directive into their national legislation. The Directive contains a considerable number of options that the Member States must consider. The accountancy profession and other relevant stakeholders are encouraged to offer assistance to their national governments in advising as to the application of these options in order to achieve the best accounting treatment and the greatest comparability across Member States. (FEE, January 2014)

The adoption of the new Directive provoked many discussions and reactions in Estonia about the possible future and changes in the Estonian accounting legislation. These reactions were especially strong, as Estonia had just adopted new accounting guidelines following the IFRS for SMEs and the public was not ready for another change.

The Estonian government believes that the failure to consider the proposals made by the Estonian' representatives during the procedure of compiling the new accounting directive has resulted in policy choices damaging Estonia's interests. In September 2013, the Estonian government submitted a claim to the European Court of Justice for the annulment of some provisions in the accounting Directive 2013/34/EU. The Directive's original objectives were to reduce administrative burdens for smaller businesses and to increase the comparability of financial reporting. In the opinion of the Estonian government, either of these objectives could not be achieved and the transposition of the Directive would affect the transparency of economic space and competitiveness of enterprises.

According to the Estonian Minister of Finance Jürgen Ligi Estonia has created a convenient e-reporting system, which has greatly facilitated presenting data by companies. The Directive is in conflict with itself and thus, in our case, forces additional reporting requirements by companies to both banks and the state. First and foremost, Estonia wants to challenge the Directive's disproportionate limitation so that the additional notes to the financial statements of small businesses submitted through e-filing system of Commercial Register can only be required for tax collection purposes. Micro- and small businesses constitute 98% of the total number of enterprises in Estonia and provide 54% of total net sales. (Ministry of Finance of the Republic of Estonia, 2013)

Since 1 January 2010, all companies, foundations and non-profit organizations have presented their financial statements through a special e-filing system. All stakeholders in the private and the public sector can use the data reported in the system. Restrictive requirements of the Directive would mean that this international award-winning system should be changed and many state agencies and private companies should contact directly other companies for more detailed information, as data once available in annual reports presented through e-filing system would vanish. The Estonian Bureau of Statistics would not have pre-filled data based on information collected through annual financial statements that help companies save time. For example, complicated annual statistical report EKOMAR was pre-filled based on the data of annual financial statements on average of 80% of cases, and 20% of data had to be added by the respondents thereto. Thus, the Directive would result, in contrast to its objectives, in the relocation and rise of the administrative burden for both, the companies and the state. (Ministry of Finance of the Republic of Estonia, 2013)

Secondly, Estonia challenges the provision of the Directive according to which the state may waive the substantive comparability of annual reports. Specifically, member states may establish a rule, which does not require financial statements to reflect the substance of the transactions, but the form. Until such provision is valid, the objective of the Directive will not be achieved – the simplification of cross-border business in the member states through comparable annual reports. (Ministry of Finance of the Republic of Estonia, 2013)

Although Estonia has challenged the EU that the new accounting directive is not suitable for Estonia, the chairman of the EASB Ago Vilu (2013) estimates that it is possible to find national solutions to the Directive's "bottlenecks" that will keep the big picture of the current accounting situation, without the need to sue the EU. When prosecuting against the new directive one must consider the cost of the lawsuit including the cost of political capital and time. Instead, one should consider alternative options that would equalize the change from the current detailed reporting to the reporting where reporting by micro- and small enterprises is not reduced so drastically. (Vilu, 2013)

For example, one could continue with the current format of the state e-filing environment, but mark the parts of financial statements required by the Directive with an asterisk, but nonetheless maintain the way information has been asked so far. Vilu (2013) also brought out the possibility that auditors may require additional information. For example, it is possible to agree between auditors that to receive an unqualified opinion, a company has to disclose more than it is required by the accounting directive, because the latter does not provide enough information. If the government should require such an agreement, it is also likely that the auditors are willing to provide it. These two measures would be sufficient to keep the current situation in accounting without the need to impose other measures, for example, through amendment of tax laws. (Vilu, 2013)

Currently, it takes time until the Directive becomes effective and therefore some can see the changes in the accounting policy in 2016. By litigating against the European Commission, Estonia may win one more year before we are forced to adopt the new accounting directive. People involved believe that Estonia will lose the court case and thus the "negative scenario" should already be taken into account when preparing for changing legislation affected by the new directive. This means significant changes in the EAA in 2015 to achieve the cohesiveness with the new Directive. Still, the opportunity to choose between the EGAP and the IFRSs probably remains as the EU has approved the IFRSs. Therefore, the adoption of a new Directive will not affect the companies, which already prepare their annual financial statements according to the IFRSs.

3.6.2. Legislation in the European Union Member States Affecting Small and Medium-Sized Entities

In this sub-chapter, the author compares national accounting legislation of all EU countries by paying attention to whether a given country has separately defined SMEs and created simplified rules for them in areas of accounting and financial reporting. The author has divided the analysis of 28 EU member states into four groups using the geographical plan developed by the United Nations (UN). Northern Europe includes Estonia, Latvia, Lithuania, Finland, Sweden, Denmark, Ireland and the United Kingdom. Eastern Europe includes Bulgaria, Poland, Romania, Slovakia, Czech Republic and Hungary. Western European member states are Austria, Belgium, the Netherlands, Luxembourg, France, and Germany. Southern Europe includes Spain, Italy, Greece, Cyprus, Malta, Portugal, Slovenia and Croatia (United Nations Statistics Division 2014). The analysis only covers private and public limited companies and is limited to the availability of information in English. The aim of this research is to identify, whether EU member states have introduced simplified rules for SME accounting to their legislation and if they have done it, then what the components of financial statements SMEs are required to compose and publish are. The analysis also views in what timeframe the SMEs are required to publish their financial statements. At the end of the chapter, the most common requirements for SMEs financial statements are outlined. This gives an opportunity to evaluate, which options from the new accounting directive should be incorporated in the Estonian accounting legislation by taking account of the common requirements and experience of other member states. Also, it helps to compare the possible opportunities available in the member states with the proposals made by the Estonian Ministry of Finance in their survey investigating possible accounting developments in Estonia in 2014-2017. In this analysis, the terms “financial statements”, “annual reports”, “annual accounts” etc. have been used in a jumble taking into account how these are used in the respective country’s accounting legislation.

3.6.2.1. Northern Europe

The author of the current dissertation has summarised the main accounting options / requirements available for SMEs in Northern Europe in Table 7. In most countries, SMEs are not defined separately for accounting and financial reporting purposes, but simplified rules have been created for smaller companies. If a country has set specific requirements for small companies compared to medium-sized or large companies, these are described separately in respect of each country below.

Table 7. Accounting and financial reporting requirements for SMEs in Northern Europe

	Estonia	Latvia	Lithuania	Finland	Sweden	Denmark	Ireland	United Kingdom
Simplified accounting rules created for SMEs	No	Yes	Yes	Yes	Yes	Yes	Yes	Yes
Components of SME financial statements								
Balance sheet	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes
Income statement	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes
Cash flow statement	Yes	Yes	No	No	No	No	No	No
Statement of changes in owner's equity	Yes	Yes	No	No	No	No	No	No
Notes to the financial statements	Yes	Yes	Yes	Yes	Yes	Yes	No	No
Management report	Yes	No	No	No	Yes	Yes	Yes	Yes
Time to file to Commercial Register after year-end	6 months	7 months	5 months	4-6 months	6 months	5 months	9 months	6-9 months

Source: composed by the author based on Estonian Accounting Act (2014), Annual Account Law of Latvia (2006), Law on Financial Statements of Entities in Lithuania (2008), Enterprise Finland (2014), Doing Business in Sweden (2014), Annex 1 for Denmark (2011), Companies Registration Office of Ireland (2014), Companies Act for United Kingdom (2006).

Latvian accounting law does not directly define SMEs, but uses the following criteria included in Table 8 to create simplified rules for accounting that may be interpreted as defining SMEs (Annual Account Law 2006).

Table 8. Small-, medium-sized and large companies according to Latvian law

	Net turnover (EUR)*	Balance sheet amount (EUR)*	Average number of employees
Small	≤ 712,000	≤ 356,000	≤ 25
Medium	712,001 – 3,415,000	356,001 – 1,423,000	26 – 250
Large	> 3,415,000	> 1,423,000	> 250

* In the original document, the amounts are defined in Latvian lats, but the calculation to euros has been made by the author of this dissertation using an approximation
Source: Annual Account Law 2006

Small-sized companies in Latvia are entitled to draw up a shortened annex and they are not required to submit a management report. In such cases an approved copy of the minutes of the general meeting of the shareholders, in which the decision taken regarding distribution of the profit or covering of the losses is set out, shall be submitted. If a management report is submitted, it does not have to contain the main characteristics of the non-financial indicators of the company and the relevant sector –information regarding the impact of environmental protection requirements and information regarding employees (for example, employment policies applied, guarantees and support to employees). (Annual Account Law 2006)

Lithuanian accounting law does not directly define SMEs, but has created simplified rules for companies not exceeding at least two indicators:

1) net turnover – LTL 10 million (approximately EUR 2.9 million);
2) balance sheet amount – LTL 6 million (approximately EUR 1.7 million);
3) average number of employees during the financial year – 15 persons.

These entities are allowed to draw up an abridged balance sheet, abridged profit (loss) account, abridged notes to the accounts and not to draw up a cash flow statement. These companies are also allowed not to draw up the management report as well, but the information, for example, in respect of the number of all the shares acquired by the entity and the entity's own shares as well as the nominal value thereof must be disclosed in the notes to their accounts. (Law on Financial Statements of Entities, 2008)

In Finland, a small entity is a company that exceeds no more than one of the following limits set below (Enterprise Finland, 2014):

1) net turnover – EUR 7.3 million;
2) balance sheet amount – EUR 3.65 million;
3) average number of employees during the financial year – 50 people.

A small entity is subject to accountability and is not obligated to prepare annual reports (i.e. management report) or financing calculations. A small entity is also able to prepare a shorter balance sheet format. The obligation to provide notes depends on the size and form of the company, as small entities have been exempted from some of the notes requirements. They can also prepare the income statement in a shorter form. A shorter layout for the income statement can be applied if no more than one of the following limits was exceeded in the last financial year and in the financial year directly preceding it (Enterprise Finland, 2014):

1) net turnover – EUR 3.4 million;
2) balance sheet amount – EUR 1.7 million;
3) average number of employees during the financial year – 25 people.

In Sweden, the annual report consists of a director's report (in some cases including a funds statement), income statement, balance sheet and notes to the accounts (Doing Business in Sweden, 2014). In the funds statement, the source and application of funds during the year are disclosed. A funds statement is mandatory only when the company is defined as a large company. A large company is (Årsredovisningslag 1995:1554, 1 §3):

1) net turnover (for the last two financial years) – SEK 80 million (approximately EUR 8.72 million);
2) balance sheet amount (for the last two financial years) – SEK 40 million (approximately EUR 4.36 million)
3) average number of employees (for the last two financial years) – 50.

All companies listed on a regulated market are large companies. Companies that are not listed or do not reach more than one of the criteria set above are small companies. Therefore, Sweden does not have the term "medium sized companies".

In Denmark, The Danish Financial Statements Act lays down both specific and general requirements for accounting principles in selected areas. The requirements in the law are divided into four accounting groups or classes in the Financial Statements Act: class A – D, where A is the small-sized personally owned business and D is for the big listed public companies. The restrictions and obligations increase in each group. The sizes for small and medium-sized entities are as included in Table 9.

Table 9. Small-, medium-sized and large companies according to Danish law

	Net turnover (EUR)	Balance sheet amount (EUR)	Average number of employees
Class A, regardless of size (personal owned partnerships, sole proprietorships)			
Class A, small-sized co-operatives	≤ 1,800,000	≤900,000	≤10
Class B, small limited companies	≤ 9,600,000	≤ 4,800,000	≤ 50
Class C (medium-sized limited companies)	≤ 38,400,000	≤ 19,200,000	≤ 250
Class C (large companies)	> 38,400,000	> 19,200,000	> 250
Class D (listed companies and state-owned companies regardless of size)			

Source: Annex 1 for Denmark (2011)

In 2013, in an effort to modernise accounting for SMEs, the Accounting Technical Committee of Danish Auditors (FSR) published a new accounting standard replacing the existing guidelines. The new, single standard issued is an updated version of the old standard for class B companies expanded to now also include class C companies. It embodies also some current accounting thinking for smaller entities as for example reflected in the IFRS for SMEs. (Denmark replaces… 22 April, 2013)

In Ireland, SMEs may be exempted from the full extent of the requirements relating to annual accounts in respect of any financial year the company satisfies two of the three following conditions included in Table 10 (Companies Registration Office 2014).

Table 10. Small-, medium-sized and large companies according to Irish law

	Net turnover (EUR)	Balance sheet amount (EUR)	Average number of employees
Small	≤ 8,800,000	≤ 4,400,000	≤ 50
Medium	8,800,001 – 15,240,000	4,400,001 – 7,620,000	51 - 250
Large	> 15,240,000	> 7,620,000	> 250

Source: Companies Registration Office (2014)

The fact that a company is entitled to an exemption on the basis of its size must be certified by its auditors. For small companies, documents that have to be annexed to the annual return include a copy of the abridged balance sheet and a special report of the auditors. For medium-sized companies, documents that have to be annexed to the annual return include a copy of the balance sheet and income statement, a copy of the report of the directors, and a special report of the auditors.

In Table 11 criteria for companies qualifying as SMEs in the United Kingdom are listed. A company is not entitled to take advantage of companies qualifying as small- or medium-sized if it was at any time within the financial year in question the company has been for example a public company, a company that carries on insurance market activity, or a member of an ineligible group. (Companies Act 2006)

Table 11. Small-, medium-sized and large companies according to the law of the United Kingdom

	Net turnover (EUR)*	Balance sheet amount (EUR)*	Average number of employees
Small	≤ 7,724,000	≤ 3,862,000	≤ 50
Medium	7,724,001–31,447, 000	3,862,001–15,724,000	51–250
Large	> 31,447,000	> 15,724,000	> 250

* In the original document, the amounts are defined in pounds, but the calculation to euros has been made by the author of this dissertation using an approximation
Source: Companies Act (2006)

Small companies must deliver to the registrar a copy of a balance sheet and may also deliver a copy of the company's income statement and a copy of the directors' report. Medium-sized companies must deliver to the registrar a copy of the balance sheet, income statement, and the directors' report. They must also deliver a copy of the auditor's report on those accounts (and on the directors' report). This does not apply if the company is exempt from audit and the directors have taken advantage of that exemption. (*Ibid.*)

3.6.2.2. Eastern Europe

For Eastern Europe, a similar summary has been prepared by the author of the dissertation in respect of accounting and financial reporting requirements available for SMEs that is outlined in Table 12. If some country has set specific requirements for small-sized companies or / compared to medium-sized companies, these are described separately in respect of each country below.

Table 12. Accounting and financial reporting requirements for SMEs in Eastern Europe

	Bulgaria	Poland	Romania	Slovakia	Czech Republic	Hungary
Simplified accounting rules created for SMEs	Yes	Yes	Yes	No	Yes	Yes
Components of SME financial statements						
Balance sheet	Yes	Yes	Yes	Yes	Yes	Yes
Income statement	Yes	Yes	Yes	Yes	Yes	Yes
Cash flow statement	Yes	Depends	No	Yes	No	No
Statement of changes in owner's equity	Yes	Depends	No	Yes	No	No
Notes to the financial statements	Yes	Yes	Yes	Yes	Yes	Yes
Management report	Depends	Yes	Yes	Yes	Depends	No
Time to file to Commercial Register after year-end	6 months	6 months	4 months	7 months	6 months	5 months

Source: composed by the author based on Accountancy Act of Bulgaria (2006), Doing Business in Poland (2014), Doing Business in Romania (2012), Annex 1 for Slovakia (2011), Annex 1 for Slovakia (2011), Annex 1 for Czech Republic (2011), Act C on Accounting for Hungary (2000).

In Bulgaria, companies, whose annual financial statements are subject to obligatory independent financial audit, also have to also draw up a management report. Companies, which do not exceed the two indicators set below, are allowed to prepare and present their annual financial statements on the basis of the National Financial Reporting Standards for SMEs. Other companies have to prepare their annual financial statements on the basis of IASs / IFRSs (Accountancy Act of Bulgaria, 2006):

1) net turnover – BGN 15 million (approximately EUR 7.7 million);
2) balance sheet amount – BGN 8 million (approximately EUR 4.1 million);
3) average number of employees – 250 persons.

Bulgarian companies may apply a simplified form of financial reporting if a company does not exceed two of the following criteria either for the previous or for the current year: total assets at the end of the year BGN 1.5 million, net revenue for the year BGN 2.5 million, and average for the year 50 full-time equivalent employees (World Bank 2008). Unfortunately, no information is available in English, what is meant under these "simplified forms".

In Poland, entities subject to obligatory audit are also required to prepare a statement of changes in equity (own funds) and cash flow statements (Doing Business in Poland 2014). In the Polish law, SMEs are not defined for accounting or financial reporting purposes. Companies, which did not reach two of the following three figures in the financial year and in the preceding year, may prepare simplified financial statement (Annex 1, Poland, 2011), unfortunately, no information is available in English, what is meant under these "simplified financial statement".

1) net turnover – no more than Polish currency equivalent of EUR 4,000,000;
2) balance sheet amount – no more than Polish currency equivalent of EUR 2,000,000;
3) average number of employees – no more than 50 persons.

In Romania, SMEs are not defined in the legislation for accounting or financial reporting purposes (Annex 1, Romania, 2011), but legal persons that do not exceed at least two of the following criteria may draft simplified annual financial statements (Doing Business in Romania 2012):

1) net turnover – EUR 7,300,000;
2) balance sheet amount – EUR 3,650,000;
3) average number of employees – 50.

The simplified annual financial statements must include a simplified balance sheet, income statement and explanatory notes to the financial statements. Optionally, simplified statements may also include references to evolution of own capitals and/or cash flow. In all cases, the annual financial statements must be accompanied by a directors' report (Annex 1, Romania, 2011).

In Slovakia, SMEs are not defined for accounting or financial reporting purposes either. The financial statements must contain the following: the balance sheet, the income statement, and the notes to the financial statements. The financial statements must also contain the cash flow statement and information on changes of equity. They are presented as part of notes to financial statements, not as separate statements. Accounting entities that must have their financial statements audited by an auditor are required to prepare an annual report, which is a wider term and includes information usually presented in the management report. There are no simplified accounting rules or financial statements for SMEs. (Annex 1, Slovakia, 2011)

In the Czech Republic, SMEs are not defined for accounting or financial reporting purposes. Components of the annual financial statement are the balance sheet, income statement, and notes to the financial statements (voluntarily cash flow statement and statement of changes in equity) (Annex 1, Czech Republic, 2011).

Accounting entities (except for joint-stock companies) that do not have to be audited can prepare abbreviated financial statements (*Ibid*.). Unfortunately, no information is available in English, what is meant under these "abbreviated financial statements" Accounting entities that have an obligation to have their financial statements audited should prepare an annual report designed to provide comprehensive information on their performance, activities and economic position (i.e. information usually presented in the management report) (Annex 1, Czech Republic, 2011).

In Hungary, SMEs are also not defined for accounting or financial reporting purposes, but some companies are allowed to file simplified reports (supported by single-entry bookkeeping). A company using double-entry bookkeeping might also prepare a simplified annual report if any of the two values are not exceeded in two consecutive years (Act C on Accounting, 2000):

1) net turnover – HUF 1,000 million (approximately EUR 3.2 million);
2) balance sheet amount – HUF 500 million (approximately EUR 1.6 million);
3) average number of employees – 50.

3.6.2.3. Western Europe

Table 13 summarises the accounting and financial reporting requirements for SMEs in Western Europe based on the same principles, as for Northern and Eastern Europe.

Table 13. Accounting and financial reporting requirements for SMEs in Western Europe

	Austria	Belgium	Nether-lands	Luxem-bourg	France	Germany
Simplified accounting rules created for SMEs	Yes	Yes	Yes	Yes	Yes	Yes
Components of SME financial statements						
Balance sheet	Yes	Yes	Yes	Yes	Yes	Yes
Income statement	Yes	Yes	Yes	Yes	Yes	Yes
Cash flow statement	No	Depends	Yes	No	No	No
Statement of changes in owner's equity	No	Depends	No	No	No	No
Notes to the financial statements	Yes	Yes	Yes	Yes	Yes	Yes
Management report	Depends	No	No	No	Yes	Depends
Time to file to Commercial Register after year-end	9 months	6 months	6-11 months	7 months	7 months	12 months

Source: composed by the author based on Annex 1 for Austria (2011), Annex 1 for Belgium (2011), Doing Business in Netherlands (2014), Annex 1 for France (2011), Annex 1 for Germany (2011)

In Austria, a management's disclosure and analysis covering the situation of the company during the previous year and in the foreseeable future must be drafted by medium-sized and large corporations. Criteria for small, medium-sized and large companies, with at least two of three applicable, are included in Table 14 (Annex 1, Austria, 2011).

Table 14. Small-, medium-sized and large companies according to Austrian law

	Net turnover (EUR)	**Balance sheet amount (EUR)**	**Average number of employees**
Small	≤ 9,680,000	≤ 4,840,000	≤ 50
Medium	9,680,001 – 38,500,000	4,840,000 – 19,250,000	51– 250
Large	> 38,500,000	> 19,250,000	> 250

Source: Annex 1 for Austria (2011)

For small and medium-sized companies the notes to the financial statements are greatly simplified. For the filing, simplifications are available in respect of the income statement (with an exemption from the requirement to analyse the gross profit figure) and in respect of the notes to the financial statements (with exemptions, in particular, from the requirement to analyse sales by areas of activity and by geographical markets etc.). (Annex 1, Austria, 2011)

In Belgium, published financial statements include a balance sheet, an income statement and annexes. The annual accounts must be accompanied by an annual report (i.e. similar to management report). Non-listed small companies are exempted from drawing-up an annual report. A small company is a company that does not exceed two of the following limits for two consecutive financial years (on a consolidated basis) (Annex 1, Belgium, 2011):

1) net turnover – EUR 7,300,000;
2) balance sheet amount – EUR 3,650,000;
3) average number of employees – 50.

If the above limits are met (or exceeded) companies are considered to be large (*Ibid.*).

The National Bank of Belgium has issued a number of standard forms that have to be used to draft and deposit the financial statements. The most important schedules to be used are abbreviated financial statements for small companies (ABB/VKT) and full financial statements for large companies (FULL/VOL) (Doing Business in Belgium 2013).

In the Netherlands, small-, medium-sized and large companies are defined using the following criteria included on Table 15 (Doing Business in Netherlands, 2014).

Table 15. Small-, medium-sized and large companies according to the Netherlands law

	Net turnover (EUR)	**Balance sheet amount (EUR)**	**Average number of employees**
Small	≤ 8,800,000	≤ 4,400,000	≤ 50
Medium	8,800,001 – 35,000,000	4,400,000 – 17,500,000	51–250
Large	> 35,000,000	> 17,500,000	> 250

Source: Doing Business in Netherlands (2014)

Micro-sized entities are not defined in the Dutch legislation (Annex 1, Netherlands, 2011). A small company does not have to include a directors' report, has no audit requirement and may file an abbreviated balance sheet and notes (including for example special formats for drawing up a balance sheet and an income statement) (Annex 1, Netherlands, 2011). In deviation from the general requirements, a small company may at its discretion prepare financial statements based on tax accounting principles. As a result, the equity and the profit according to the annual accounts are equal to the equity and profit according to the corporate tax return. This facility was introduced in the Dutch law in order to reduce the administrative burden for small entities. A medium sized company must be audited, but is permitted to file an abbreviated income statement as part of the financial statements and is exempt from including certain notes to the balance sheet. (Doing Business in Netherlands 2014)

In Luxembourg, companies, which on their balance sheet dates do not exceed the limits of two from the following criteria, may draw up an abridged balance sheet (Luxembourg Company Law of 10th August 1915):

1) net turnover – EUR 8,800,000;
2) balance sheet amount – EUR 4,400,000;
3) average number of employees – 50.

These entities can also draw up abridged notes to the annual accounts. For example, they do not have to disclose the nature and business purpose of the arrangements that are not included in the balance sheet and their financial impact on the company. These companies are also not compelled to prepare an annual management report, if they include information about the acquisition of own shares in the notes, and are exempted from the obligation to have their annual accounts audited. (*Ibid.*)

Companies, which on their balance sheet dates do not exceed the limits of two from the following criteria, may draw up an abridged income statement starting from gross profit (loss) (*Ibid.*):

1) net turnover – EUR 35,000,000;
2) balance sheet amount – EUR 17,500,000;
3) average number of employees – 250.

Also, companies whose sole purpose is to invest in and develop other companies may disclose a balance sheet and income statement in a format that deviates from the general provisions of the law. Given that these companies generally have a reduced number of staff and no turnover, they qualify as small companies. Hence, they can disclose abridged notes to the accounts and are not obliged to disclose their investments and a management report. (Doing Business in Luxembourg 2014)

In France, although SMEs are not directly defined for accounting or financial reporting purposes, simplified rules have been created for companies that meet the criteria described in Table 16.

Table 16. Small-, medium-sized and large companies according to French law

	Net turnover (EUR)	Balance sheet amount (EUR)	Average number of employees
Small	≤ 534,001	≤ 267,000	≤ 10
Medium	534,001–7,300,000	267,001–3,650,000	11–50
Large	> 7,300,000	> 3,650,000	> 50

Source: Annex 1 for France (2011)

Components of financial statements include basic presentation of the balance sheet, income statement, notes to the financial statements. Entities have to present all of these if they classify as "large" according to Table 16. They can present a basic balance sheet, income statement and simplified presentation of the notes to the financial statements if they classify as "medium-sized" according to Table 16 and they can present a simplified balance sheet, income statement and notes to the financial statements if they classify as "small" according to Table 16 Directors' report has to be filed together with the financial statements. (Annex 1, France, 2011)

In Germany, an entity qualifies as small or medium if it meets two out of the following three criteria on two consecutive annual reporting dates included in Table 17 (Annex 1, Germany, 2011).

Table 17. Small-, medium-sized and large companies according to German law

	Net turnover (EUR)	Balance sheet (EUR)	Average number of employees
Small	≤ 9,680,000	≤ 4,840,000	≤ 50
Medium	9,680,001–38,500,000	4,840,001–19,250,000	50–250
Large	> 38,500,000	> 19,250,000	> 250

Source: Annex 1 for Germany (2011)

For small and medium-sized companies the notes to the financial statements are greatly simplified. The management of private and public limited companies are required to prepare a management's report providing additional information, i.e. containing comments on post-balance sheet date events of special importance, on the anticipated development of the company, on research and development activities, and on the use of financial instruments (including a description of the risk management of the entity). Management report is not required for small-sized companies. (*Ibid.*)

3.6.2.4. Southern Europe

Table 18 summarises the accounting and financial reporting requirements for SMEs in Southern Europe.

In Spain, small companies may file abridged accounts (balance sheet, income statement, statement of changes in equity and notes to the annual account) providing they do not exceed the following limits for two consecutive years (Annex 1, Spain, 2011):

1) net turnover – EUR 5,700,000
2) balance sheet amount – EUR 2,850,000
3) average number of employees – 50.

Companies which are permitted to present abbreviated income statements are not required to include non-financial information in the management report. Companies which prepare abbreviated balance sheets and statements of changes in equity are not required to prepare a management report. (*Ibid.*)

The enterprises or individuals that opted for SMEs may apply specific criteria for micro enterprises if they meet at least two of the following conditions for two consecutive financial years (*Ibid.*):

1) net turnover – EUR 2,000,000;
2) balance sheet amount – EUR 1,000,000;
3) average number of employees – 10.

Unfortunately, Annex 1 for Spain (2011) does not contain information, whether micro-enterprises can apply further simplified rules for financial statements compared to small companies.

In Italy, SMEs are not defined in legislation for accounting or financial reporting purposes. The abridged financial statements are allowed if for two consecutive accounting periods the company does not exceed two of the following conditions (Annex 1, Italy, 2011):

1) net turnover – EUR 8,800,000
2) balance sheet amount – EUR 4,400,000
3) average number of employees – 50.

If a company is allowed to draw up an abridged financial statement, it can be exempted from preparing the management's report if some compulsory information is given directly in the note s to the financial statements. (*Ibid.*)

In Greece, SMEs are not defined in legislation for accounting or financial reporting purposes. The annual financial statements include a balance sheet, an income statement, the appropriation of profits account and the notes to the financial statements. Companies, where two of the following three criteria are not exceeded, are allowed to publish summary financial statements (Annex 1, Greece, 2011). Unfortunately, the author could not find in the English literature, what is meant under "summary financial statements":

1) net turnover – EUR 5,000,000;
2) balance sheet amount – EUR 2,500,000;
3) average number of employees – 50.

For public limited company a director's report has to be filed together with the financial statements. For private limited company an administrator's report has to be filed together with the financial statements (*Ibid.*). Unfortunately, the author could not find in the English literature, what the difference between director's (i.e. management) and administrator's report is.

Table 18. Accounting and financial reporting requirements for SMEs in Southern Europe

	Spain	Italy	Greece	Cyprus	Malta	Portugal	Slovenia	Croatia
Simplified accounting rules created for SMEs	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes
Components of SME financial statements								
Balance sheet	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes
Income statement	Yes	Yes	Yes	Yes	No	Yes	Yes	Yes
Cash flow statement	No	No	No	No	No	No	Depends	No
Statement of changes in owner's equity	Yes	No	Yes	No	No	No	Depends	No
Notes to the financial statements	Yes	Yes	Yes	Yes	Yes	Yes	Yes	Yes
Management report	Depends	Depends	No	Depends	No	No	Depends	No
Time to file to Commercial Register after year-end	7 months	6 months	Info not available	7 months	7-10 months	7 months	3-8 months	6 months

Source: composed by the author based on Annex 1 for Spain (2011), Annex 1 for Italy (2011), Annex 1 for Greece (2011), Doing Business in Cyprus (2014), Doing Business in Malta (2013), Annex 1 for Portugal (2011), Annex 1 for Slovenia (2011), Accounting Act for Croatia (2008)

Cyprus law defines a “small sized company” which shall not exceed at least two of the three of the following criteria, throughout the financial year (Doing Business in Cyprus, 2014):

1) net turnover – EUR 6,834,000;
2) balance sheet amount – EUR 3,417,000;
3) average number of employees – 50.

Small sized private companies, the securities of which are not admitted for negotiation to a regulated market of a member state and which are not obliged to submit consolidated financial statements, are exempted from the obligation concerning the analysis of non-financial and economic information in the management report. (*Ibid.*)

According to the law, the financial statements must be submitted within 18 months after the establishment of the company, and thereafter at least once each calendar year, but not less than six months after the end of the financial year. (Doing Business in Cyprus, 2014)

In Malta, certain qualifying companies may elect to adopt the General Accounting Principles for Smaller Entities regulations (GAPSE) as their accounting framework. Both quantitative as well as qualitative criteria must be met for a company to qualify for adoption of GAPSE. GAPSE can be adopted by companies which do not exceed any of the following three criteria (Doing Business in Malta 2013):

1) net turnover – EUR 35 million;
2) balance sheet amount – EUR 17.5 million;
3) average number of employees – 250.

GAPSE cannot be adopted by companies if, amongst others (*Ibid.*):

- a shareholder holding at least 20% of the entity’s shares has served notice on the company to prepare financial statements that comply with the IFRSs as adopted by the EU;
- the entity’s securities are listed;
- the entity is a guarantor of the principal or interest on securities that are listed;
- the entity is a public company; or
- the entity holds a licence or other authorisation by the Malta Financial Services Authority.

A set of financial statements include a balance sheet and income statement, together with any other statement and accompanying notes as required in terms of IFRSs as adopted by the EU or, if applicable, as required in terms of the GAPSE. The GAPSE contains a number of measurement simplifications when compared to the IFRSs as adopted by the EU. For example, all recognised assets may, under GAPSE, be measured at cost less, if applicable, impairment. GAPSE also contains a number of disclosure relaxations when compared to the IFRSs as adopted by the EU. For example, disclosure about critical accounting estimates and judgements, financial risk and capital management are not required. (*Ibid.*)

Abridged accounts may be drawn up by small companies, defined as companies that on their balance sheet date do not exceed the limits of two of the following three criteria (*Ibid.*):

1) net turnover – EUR 5.12 million
2) balance sheet amount – EUR 2.56 million
3) average number of employees – 50.

Small private companies are allowed to publish abridged financial statements which exclude the directors' report, the income statement, and certain notes to the financial statements. (*Ibid.*)

In Portugal, SMEs are not defined in legislation for accounting or financial reporting purposes, but a special accounting standard for small companies is applicable for entities that do not exceed two of the following limits (Annex 1, Portugal, 2011):

1) net turnover –EUR 1,000,000;
2) balance sheet amount – EUR 500,000;
3) average number of employees – 20.

The financial statements of small companies comprise a balance sheet, income statement by natures and notes to financial statements, but required disclosures are less extensive. (*Ibid.*)

In Slovenia, companies are classified into micro, small, medium-sized and large companies on the basis of the following criteria at the balancing date of the annual balance sheet (on the basis of the data of two consecutive business years) that are included in Table 19.

Table 19. Micro-, small-, medium-sized and large companies according to Slovenian law

	Net turnover (EUR)	**Balance sheet amount (EUR)**	**Average number of employees**
Micro	≤ 2,000,000	≤ 2,000,000	≤ 10
Small	≤ 7,300,000	≤ 3,650,000	≤ 50
Medium	≤ 29,200,000	≤ 14,600,000	≤ 250
Large	> 29,200,000	> 14,600,000	> 250

Source: Annex 1 for Slovenia (2011)

The annual report of large and medium-sized companies and the annual reports of small companies whose securities are traded on the regulated market hereof must contain a balance sheet, income statement, cash flow statement, capital flow statement, annexes with notes to financial statements and business report (i.e. management's report). (*Ibid.*)

The annual report of small companies with share capital whose securities are not traded on the regulated market must comprise at least a balance sheet, income statement and annexes with notes to financial statements. (*Ibid.*)

The business report must set out at least a fair presentation of the development and results of the company's operations and its financial position, including the description of essential risks and uncertainties the company is exposed to. The business report is not compulsory for micro and small companies (*Ibid.*)

Annual reports shall be submitted for the purpose of publication, together with the auditor's opinion, within eight months of the end of the financial year. The annual report of small companies whose securities are not traded on the regulated market shall be submitted for the purpose of publication within three months of the end of the financial year. (*Ibid.*)

In Croatia, companies are classified into small, medium-sized and large companies on the basis of the following criteria at the balancing date of the annual balance sheet (on the basis of the data of two consecutive business years) that are included in Table 20.

Table 20. Small-, medium-sized and large companies according to Croatian law

	Net turnover (EUR)*	Balance sheet amount (EUR)*	Average number of employees
Small	≤ 8,517,000	≤ 4,250,000	≤ 50
Medium	8,517,001 – 34,069,000	4,250,001 – 17,035,000	≤ 250
Large	> 34,069,000	> 17,035,000	> 250

* In the original document, the amounts are defined in Croatian kunas, but the calculation to euros has been made by the author of this dissertation using an approximation
Source: Accounting Act of Croatia (2008)

Small entrepreneurs are not obliged to prepare the management report, but they must disclose the information about repurchase of own shares in the notes to the financial statements.

3.6.2.5. Conclusion on Legislation in the European Union Member Countries Affecting Small and Medium-Sized Entities

The purpose of this sub-chapter is to make conclusions on different requirements for SME accounting in EU member states based on the information gathered in previous sub-chapters. The aim was to identify the components of financial statements SMEs are required to compose and publish in the EU member states. Although the previous analysis was conducted using four regions in Europe – northern, eastern, western and southern – then further analysis based on the same criteria seemed unreasonable, because the previous analysis showed that although similarities in legislation exist between countries, these countries are not always located in the same region. An analysis by legal system could be done (i.e. common law versus code law), but this analysis was not the purpose of this sub-chapter. Therefore, a general conclusion has been made.

The author would like to emphasize that there are only few countries in the European Union which have defined the term SMEs for accounting purposes. These include for example, the United Kingdom, Ireland and Austria. But in many member states, simplified rules for composing or filing annual financial statements have been created for small and/or medium-sized companies or for companies that are not audited. There are also countries, were no simplifications have been established for SMEs – for example Estonia and Slovakia.

When defining SMEs quantitative criteria have been used. The financial figures of these companies usually cannot exceed at least two of the three predetermined thresholds – net turnover, total assets, and the average number of employees. For small companies, these thresholds vary very much by country, starting from EUR 0.4 million for assets and EUR 0.7 million for net turnover and ending with 4.8 EUR million for assets and EUR 9.7 million for net turnover. The average number of employees for smaller entities is usually up to 50 employees. There are only a few countries (for example Slovenia), which have also defined micro entities as it is done in the Accounting Directive 2013/34/EU. The author is of the opinion of that it is neither expendable nor reasonable to calculate any averages of thresholds for SMEs used in different member states and to compare them with proposals made by the Ministry of Finance of Estonian in "Accounting Developments 2014-2017 – analysis of the questionnaire" or thresholds set in the Accounting Directive 2013/34/EU. On one hand, the variation between countries shows the need for harmonization, on the other hand, the harmonization may not take into account the country specific factors. For example, in Latvia, the thresholds for defining SMEs have been set much lower than in Germany. When looking at the economic backgrounds of these countries, they differ a great deal and therefore, maybe different thresholds for SMEs can be justified? For example, the Estonian Ministry of Finance (2014) made a proposal that if Estonia should accept the criteria for SMEs as defined in Directive 2013/34/EU this should be supplemented with a definition of nano entities. These include companies who have one shareholder, whose balance sheet total is less than EUR 60,000 and whose liabilities do not comprise more than 50% of total balance sheet. This kind of proposal was made, because nano companies constitute 8% of all companies in Estonia.

When viewing possible simplifications available for SMEs in different member states, these again vary significantly. In most countries, irrespective of the size of the company, the annual report consists of a balance sheet, an income statement, notes and a management report. In many countries, SMEs are exempted from drawing up a management report, if they disclose some additional information in the notes. There are only a few countries, which require a "complete" set of financial statements, including statement of cash flows and statement of changes in equity. These countries include for example Estonia, Latvia and Lithuania. But even in the latter two, simplified rules have been created for smaller entities – for example, they do not have to draw up a statement of cash flows or can draw up an abridged balance sheet and income statement. When comparing the simplifications available in member states today and the new Accounting Directive 2013/34/EU, in the latter small companies may prepare an abridged balance sheet, income statement and limited notes to the financial statements. They are exempted from the preparation and publication of a management report and from the publication of the income statement. In many of the member states, similar exemptions have already been created for small and / or medium-sized companies or for companies, which are not audited. When comparing the simplifications available in member states and the proposal made by the Estonian Ministry of Finance (2014), the latter suggested that only nano companies should be exempted from preparing a management report and notes to the financial statements and they should only be obligated to publish information about the balance sheet.

When looking at the timeframe when financial statements have to be submitted/filed to commercial register or other regulative body, this usually varies from 3 to 12 months. It is more common that the submission has been elongated for SMEs (i.e. SMEs have more time to submit their annual financial statements than listed companies or public interested entities). This contradicts to the proposal made by the Estonian Ministry of Finance (2014), who suggested that publishing the annual report in the electronic Commercial Register should be 4 months instead of 6 months for companies, whose annual financial statements are not audited. Although this view was more supported than rejected, it is interesting to point out that all the umbrella organizations inquired (Chamber of Commerce, The Estonian Board of Accountants, The Estonian Board of Auditors, Estonian Accounting Standards Board) were against the proposal (Ministry of Finance of the Republic of Estonia, 2014). They argued that shortening the publication period will increase the administrative burden of SMEs. When looking at the new accounting directive of the EU, this states that "Member States shall ensure that undertakings publish within a reasonable period of time, which shall not exceed 12 months after the balance sheet date". With that, the EU gives a lot of flexibility to member states to establish the publishing timeframe for SMEs. The author of this dissertation believes that from one perspective, when SMEs are given the opportunity to compile abbreviated financial statements it should take them less time and therefore, a shorter period can be justified. Also, when taking into account the possible interest of the users of these financial statements, they would assumably prefer to get the information rather sooner than later. On the other hand, the author understands that a shorter period may increase the administrative burden of smaller companies for example through increasing fees they have to pay to accountants who prepare the annual reports.

To conclude, in most of the EU member states, simplified rules for compiling and the publishing annual report have been created. The most common one for smaller entities is that they have to prepare a (abridged) balance sheet and (abridged) income statement with notes. In more than half of member states, small and/or medium-sized companies, companies, who are not audited, or companies, who have the right to present simplified annual reports, have been exempted from drafting management report. When comparing this with the options currently available in Estonia, one could make suggestions for improvement. Based on the analysis of Accounting Directive 2013/34/EU and the legislation effective in the EU member states, the author believes that Estonia should start from defining SMEs and a proper basis for that seems to be Accounting Directive 2013/34/EU. The term "nano companies" and supplementary accounting rules for them are unnecessary, because the requirements for SMEs (including micros) are already quite minimal and cutting them down further may seriously affect the transparency. The Directive contains a considerable number of options that the member states must consider – for example whether to exempt small entities from the preparation of a management report or to permit the preparation of an abridged management report (excluding non-financial key performance indicators). The author believes that Estonia should use the options that would allow the preparation and publication of "maximum" annual report so that more information would be available and the transparency of economic space and competitiveness of enterprises would not be damaged.

3.7. Concluding Remarks on Financial Reporting of Small and Medium-Sized Entities

The aim of this chapter was to give an overview about the users of financial statements of SMEs, their information needs and legal environment created for SMEs financial accounting and reporting purposes.

Firstly, the author would like to point out that the debate on the "Big GAAP" versus "Little GAAP" has found pros and cons for both sides, but the recent developments at the international level (IASB, EU) show clearly, that those favouring the "Little GAAP" have won, because all significant organizations are focusing on developing simplified accounting requirements for SMEs nowadays. These simplified rules may be restricted to disclosure or may also affect recognition and measurement. Relaxations regarding disclosure are more common, as these seem to be more acceptable than differentiation of recognition and measurement principles, since the latter directly impact on the reported profit figure, reduce comparability between enterprises, and may increase the risk of misinterpretation by financial statement users. The development of simplified accounting requirements for SMEs is often hindered by barriers faced by them. For example, SMEs may be aware of standards but not realise that they can actively participate in and influence the development process. Some believe this is due to the low awareness amongst SMEs and their employees, and a failure to create awareness through appropriate and sufficient communication activities. Whatever the reasons are, the analysis about differential reporting has shown that this is an important topic that should be considered in Estonia when modifying the existing or developing a new accounting framework. Whether the differentiation should be based on qualitative or quantitative criteria and modify the accounting principles or compiling and filing requirements has to be decided taking into account the country specific factors.

Secondly, the author analysed SME financial statement users and uses based on the literature. The research conducted has shown that the internal SME financial statement users are management and directors and external banks and other credit institutions and trade creditors. But understanding about the financial statement users of SMEs varies quite significantly. Whether this is influenced by country specific factors, cultural aspects or the legal framework is hard to say. Therefore, the author believes that further research in this area is necessary, including in Estonia. The uses of SME financial statements were analysed from the perspective of main users. For the management and owners of small companies, the most useful sources of information are the annual report and accounts, cash flow information and bank statements. For the management and owners of medium-sized companies, it was the management accounts, cash flow information and budgets respectively. The bankers were most interested in business environment, future cash flows and income statement for repayment analysis, sensitivity analysis for assessing risks, and the past and current financial position for testing forecasts. Again, the prior overview showed that the uses of SME financial statements differed among users and therefore, it is essential to find out the users preferences in Estonia in order to make grounded decisions in respect of future accounting and reporting rules. Although it may not be possible to satisfy the needs of all the user groups, an in-depth research may give a better overview of common elements of interest by different user groups. When conducting such analysis, one should also bear in mind the criticism about prior research. The future research should not only bear in mind the decision-usefulness aspect, but should examine what the reports, financial ratios or other indicators users bear in when making decisions about entities are. The author also admits that there are some limitations that would be hard to overcome. Firstly, when trying to investigate all the user groups of SME financial statements, self-selection seems to be the best option to identify the potential users and their function as suppliers, customers, employees etc. But self-selection may lead to over- or underrepresentation of some user groups and would make it hard to take into account the fact that one user can be more influential than another user. Secondly, previous studies conducted among SMEs have struggled with low response rates. The reasons for low response rates can only be assumed – whether it is because of wrong targeting of the main user groups (i.e. the sample) or about the ignorance or incompetence of SME financial statements users. The study conducted by the author tries to overcome some of the limitations of the previous research or at least bear these in mind when conducting her own research.

Thirdly, the analysis conducted in respect of the EU and its member states legislation showed, that Estonia is one of the few countries in the EU were simplified requirements have not been created for SMEs. The author is of the opinion that this should be changed and the starting point should be defining the criteria for SMEs. This can be done best by using quantitative criteria as this is easier for the entities to interpret and a proper basis seems to be the new Accounting Directive. The author also believes that Estonia should use the options in Directive 2013/34/EU that would allow the preparation and publication of as comprehensive annual report as possible so that more information would be available and the transparency of economic space and competitiveness of enterprises would not be damaged.

Taking into account how accounting legislation in Estonia has historically changed (due to the political changes or direct coercive influence by the EU and the IASB), one should consider whether the changes have really been justified and meet the needs of financial statement users. Although research has been carried out at the EU level among SMEs and their financial statement users (for example, European Commission Study on Accounting Requirements for SMEs, 2011), this has actually not involved any of the Estonian companies or stakeholders. In addition, bearing in mind the effect of the new accounting directive on micro- and small entities that constitute 98% of the Estonian companies, one should ask them and their financial statement users whether the changes in the accounting directive are acceptable for them, or whether they would perhaps continue to provide information in the e-filing system as it has been asked so far.

4. USERS AND USES OF SMALL AND MEDIUM-SIZED ENTITIES FINANCIAL STATEMENTS IN ESTONIA

In this chapter the author concentrates on the financial statement users and uses of Estonian SMEs. Firstly, the author gives a short overview of the main economic factors describing the current macro-economic environment in Estonia that also affects SMEs. The author believes this information is important to gain an understanding about the financial and economic environment that may affect the activities and decision processes of SMEs and set the background for a deeper study about the users and uses of SME financial statements in Estonia. Therefore, this chapter also includes the main facts about the SMEs of the European Union to compare the Estonian indicators with other European countries and look for similarities or differences.

Secondly, the author has taken into account the literature review in Chapter 3 about the financial statement users and uses, criticism of prior research in respect of differential reporting, the current accounting legislation changes taking place in the European Union and in Estonia to compose a questionnaire to investigate the perceptions of SME financial statement users about the usefulness of the information available to them. To gain more insight into the problems faced by the SME financial statement users, the author has also conducted interviews with both the preparers and users of SME financial statements. The results of these interviews have also been used to compose the questionnaire for the survey.

Thirdly, the author has conducted a survey using a questionnaire to map the financial statement users and uses in Estonia and has compared the results with the current accounting legislation to identify whether the needs of the users and the output of accounting legislation (i.e. financial statements) are compatible. The author has also taken into account the possible future changes in the accounting legislation and has compared these to the results of the survey to analyse to what extent Estonia should take over the changes proposed by the European Union into its accounting legislation. When composing the questionnaire, the author has borne in mind the principles of proprietary versus entity theory (including asset-liability versus revenue-expense approach etc.) to analyse which sections of the financial statements are seen as the most important or useful by the users of financial statements and from whose perspective (proprietor versus entity) the financial statements should be composed.

4.1. Overview of the Small and Medium-Sized Entities in European Union and in Estonia

The overwhelming majority (99.7%) of enterprises active within the EU-27's non-financial business economy[14] in 2010 were SMEs (employing fewer than 250 persons) – some 21.7 million. Perhaps the most striking phenomenon of SMEs is their contribution to employment. More than two thirds (67.5%) of the EU-27's non-financial business economy workforce was active in an SME in 2010, some 89.6 million persons. Across the whole of the EU-27's non-financial business economy, SMEs accounted for 57.5% of the EUR 5.95 billion of value added generated in 2010. (Eurostat, 2013)

There were 58,347 non-financial corporations (enterprises) operating in Estonia in 2010. After the stagnation in 2009, the activeness in setting up enterprises increased. There was a rapid increase in the number of micro-enterprises (employing fewer than 10 persons), while in the other size classes the number of enterprises decreased. The majority of Estonian enterprises are micro-enterprises. In 2010, their proportion was 89% – seven percentage points higher than in 2005. Since 2005, the number of micro-enterprises has increased by more than 17,000, whereas in the other size classes the number of enterprises has decreased by 1,000 in total. The importance of micro-enterprises has steadily risen, both in the number of enterprises and in the indicator values. (Statistics Estonia, 2012)

More than 9 out of 10 enterprises in the EU-27's non-financial business economy were micro enterprises (employing fewer than 10 persons). Their relative share of the non-financial business economy workforce and value added was considerably lower (at 29.9% and 21.2%). As such, micro enterprises accounted for the second highest share of employment and value added among the four enterprise size classes that are distinguished in Table 21. Their relatively high weight in terms of their contribution to employment and value added was countered somewhat by the fact that they recorded the lowest level of apparent labour productivity, at EUR 31.8 thousand per person employed. (Eurostat, 2013)

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[14] The non-financial business economy includes the sectors of industry, construction and distributive trades and services. This refers to economic activities covered by Sections B to J and L to N including S95 of NACE Rev. 2 and the enterprises or its legal units that carry out those activities. Business services are activities (business functions) performed by an enterprise for another enterprise and/or the public administration. They include technical services such as engineering, architecture and technical studies; computer services such as software design and database management; other professional services such as legal, accounting, consultancy and management services. The business services sector refers to the economic activities covered by NACE Rev. 2 Divisions 62, 69, 71, 73 and 78 and Groups 58.2, 63.1 and 70.2, and the enterprises or parts of enterprises that carry out those activities.

Table 21. Key size class indicators, non-financial business economy, EU-27, 2010

	Number of enterprises (thousands)	Number of persons employed (thousands)	Value Added (EUR million)	Apparent labour productivity (EUR thousand per head)
All enterprises	***21,801***	***132,796***	***5,946,968***	***44.8***
All SMEs	**21,371**	**89,587**	**3,422,300**	**38.2**
Micro	20,154	39,646	1,261,663	31.8
Small	1,355	27,231	1,060,761	39.7
Medium	222	22,711	1,079,876	47.5
Large	**42**	**43,157**	**2,518,044**	**58.3**

Source: Eurostat

There were more than 400,000 persons employed in the enterprises of Estonia in 2010 – nearly 17,000 less than the year earlier. The reduction in staff concerned all enterprise size classes, except for micro enterprises where the number of persons employed was 4,400 more in 2010 than in 2009. In the period 2005–2010, the employment in small, medium-sized and large enterprises decreased by 54,000 persons in all, but a third of them found jobs in micro-enterprises. (Statistics Estonia, 2012)

Some 23.5 million persons worked in SMEs in the EU-27's distributive trades sector in 2010, 18.0 million in manufacturing, 11.9 million in construction and 9.1 million in the professional, scientific and technical activities sector – together, these for activities provided work to 69.8 % of the non-financial business economy workforce in SMEs. The SMEs as employers have a prominent role within many areas of the non-financial business economy. Micro-enterprises employed more people than any other size class in a number of sectors. Among the four enterprise size classes, small enterprises or medium-sized enterprises never accounted for the highest share of the EU-27 workforce within any of the NACE sections that compose the non-financial business economy. (Eurostat, 2013)

As noted above, the contribution of SMEs to the generation of value added within the non-financial business economy was lower than their contribution to the non-financial business economy workforce, resulting in a lower level of apparent labour productivity. This pattern was particularly prevalent among activities where large enterprises tended to play an important role, for example, in the manufacturing sector or for information and communication services. However, it was also observed across most other activities (and across most of the EU Member States) suggesting that the inherent characteristics of SMEs played a role — for example, their inability to benefit from economies of scale, their relatively low level of capital intensity, or their lower propensity to innovate. (Eurostat, 2013)

The relative importance of SMEs was particularly high in the southern Member States of Cyprus, Italy, Portugal and Spain, as well as the Baltic Member States and Bulgaria.

In each of these countries, SMEs accounted for more than three quarters of the non-financial business economy workforce in 2010. Some of these differences may be explained by the relative importance of particular sectors in each national economy, or by cultural and institutional preferences for self-employment and/or family-run businesses (see also Table 22). By contrast, less than two thirds of the non-financial business economy workforce was found to be working for SMEs in Romania, Sweden, France, Germany, Finland and the United Kingdom in 2010. (Eurostat, 2013)

Table 22. Number of persons employed by enterprise size class in EU-27 and Estonia, non-financial business economy, 2010

	Total (thousands)	SMEs (% of total)	Micro (% of total)	Small (% of total)	Medium-Sized (% of total)	Large (% of total)
EU-27	132,798	67.5	29.9	20.5	17.1	32.5
Estonia	366	78.6	29.1	25.0	24.5	21.4

Source: Eurostat 2013

Table 23 provides a similar analysis, based on a breakdown of non-financial business economy value added between the different enterprise size classes. Among those EU Member States for which data are available, SMEs accounted for more than two thirds of the value added generated within the non-financial business economies of Italy, Latvia, Portugal, Estonia and Cyprus (where the highest share was recorded, at 76.0 %). (Eurostat, 2013)

Table 23. Value added by enterprise size class in EU-27 and Estonia, non-financial business economy, 2010

	Total (million)	SMEs (% of total)	Micro (% of total)	Small (% of total)	Medium-Sized (% of total)	Large (% of total)
EU-27	5,946,968	57.6	21.2	18.2	18.2	42.4
Estonia	7,247	74.7	21.6	24.0	29.0	25.3

Source: Eurostat 2013

In 2011, Praxis Centre for Policy Studies conducted a survey among Estonian small and medium-sized entities to explore the factors which favour or hinder their economic development. The questions were answered by company directors, members of management board or chief financial officer. The topics of the survey included among other things the availability of financial resources and awareness of and satisfaction with enterprises' support measures and enterprises' legal environment. The author would like to emphasize that this survey was more general in nature and did not include any information about the SME financial statements users and uses. The results showed that among the five major problems affecting the operations of SMEs were also burdensome regulations and red tape (38%) and the availability of financial resources (34%). (Praxis, 2012)

SMEs were asked to assess which were the three areas where legislation prevented the operations of their business the most. The results have shown that the most restrictive legislation that affects business activities is tax-related (29%), accounting related (18%) or connected with the Statistics and Intrastat reporting requirements (17%). For medium-sized business managers the most obstructing factors almost equally involved public procurement requirements (23%) and the Statistics and Intrastat reporting requirements 23%), they ranked third the safety requirements of work environment (15%). For micro-entities the main problems with legislative environment are related to tax procedures (35%) and accounting requirements (28%) (Praxis, 2012). Although the specific problems relating to accounting legislation are not outlined in the survey, the author believes that this may be again an indication that further research in this area is necessary, before one can make specific policy suggestions how to minimize the accounting burden among SMEs.

Another problem that this survey raised was related to the financing of SMEs. It was found that during 2009-2011 31% of SMEs used a funding opportunity. It has been done more by small (10-49 employees) and medium-sized (50-250 employees) entities – 45% and 47% respectively. Additional financing is an important source of capital and entrepreneurs have borrowed money from their friends and family (51%), used leasing (48%) and bank loans (37%). It is interesting that most of the increased borrowing has come from family and friends. Is this an indication that the financial sector has stagnated during and after the economic crisis? Probably not, because family or friends are used as a funding source primarily by micro businesses (1-10 employees) and sole proprietors, and the loan amount remains under 25,000 euros. Since micro-enterprises may have a number of obstacles (not enough self-financing, financial indicators are not sustainable, etc.) to access banking products, it is probably preferred by them to borrow from family or friends. Companies who hire more than 10 employees make use of this opportunity significantly less (Praxis, 2012). The author believes that this shows that various groups among SMEs (micro, small and medium-sized entities) behave differently when it becomes to financing. As bankers were seen as one of the main user groups of SME financial statements in the analysis conducted by the author, one can conclude that in Estonia, banks may be more interested in the financial statements of small and medium-sized entities rather than micro-entities. Therefore, one should bear the interest of bankers in mind when drafting accounting legislation for small and medium-sized entities. For micro-entities, based on the survey conducted by Praxis (2012), banks are not the main source of financing and therefore the author can conclude, not also the main user of their financial statements.

According to Statistics Estonia there were 12.8% of exporters among SMEs in 2010. Among SMEs the number of exporting companies in 2005-2010 has increased, but the proportion of exporting firms, however, has remained at the same level. In general, SMEs are less interested in export activities than large firms, but since there is a large proportion of SMEs in the economy, their export accounts for a substantial majority (over 75%) of the total export volume of the economy. In this study, 23% of SMEs exported its products or services in 2011. Medium-sized companies stand out very clearly in terms of size, where the share of exporters was 67% compared to that of small enterprises (10-49 employees) where 50% of entities were engaged in export. But it has been shown in earlier studies that foreign-owned companies export more – the proportion of such companies was 50% in 2011 (Praxis, 2012). One of the arguments of the European Commission, when drafting the new accounting legislation for micro-entities was that micro-entities are in most cases engaged in business at the local or regional level with no or limited cross-border activity. Therefore, these companies should be exempted from some requirements of the Accounting Directives.

Based on the previous analysis about the significant impact of the SMEs on the economy of the EU, it is hard to overestimate their importance. Therefore, the need to design a suitable economic environment for SMEs is also highlighted in the economic policy of the EU. For example, the basic principle of the European Commission's "Small Business Act" (2008) is to "think small first". That means that regulations must conform to the majority of users (including the users of SMEs financial statements). This has also arisen to the agenda of the EU to change the current accounting directives to upgrade to the needs of SMEs. According to Evans *et al.* (2005) as compared, for example with the USA, in the EU larger numbers of SMEs are affected by company law (and, presumably, other regulations), making compliance costs more relevant and the enforcement of new legislation more difficult. Therefore, the question arises as to whether a regulatory framework developed initially for firms reporting within an Anglo-American governance and capital market context, such as the IFRS for SMEs developed by the IASB, can usefully be adapted to the needs of SMEs in EU member states (and elsewhere) (Evans *et al.*, 2005).

4.2. Survey of the Small and Medium-Sized Entities in Estonia

4.2.1. Research Questions and Connection to Prior Chapters of the Thesis

The study was carried out among micro, small and medium-sized companies using a questionnaire (see also Chapter 4.2.2 for reasoning), which was divided into seven parts. One of the aims of the author's research was to take into account the criticism pointed out by other researchers in prior studies, when analysing financial statement users and uses, for example, that the future research should not only bear in mind the decision-usefulness aspect, but has to examine what reports, financial ratios or other indicators users review when making decisions about entities. Also, the future studies should investigate not only the management and bankers as the main user group, but also take into account other user groups identified in prior research.

The first part of the questionnaire included questions about the company on whose behalf the respondent gave answers. The information gathered included the main financial indicators of the company such as total revenues, total assets and the average number of employees to determine in which size class the company belongs to. This information was gathered to divide respondents between micro, small and medium-sized companies. This grouping was later on used to determine whether the opinions and responses of different size-groups vary, for example, whether micro entities review distinct reports and statements that medium-sized entities do not use.

The second part included questions about the company's financial statements, the main users of the company's financial statements from the preparers' point of view (i.e. who are the actual users to whom the financial statements are provided and who are the perceived users who are considered to be using the financial statements of the company, but to whom the company does not itself provide financial statements) and the estimated costs of preparing financial statements. This research was indirectly linked to Chapter 3.4 of the thesis, which analysed the users of the financial statements. The aim of the second part of the questionnaire was also to evaluate the implementation of the new EASB guidelines effective starting from January 1, 2013.

The third part included more questions about the users and uses of a company's financial statements. The questions in the third part covered:

- By whom (user) are the financial statements of other SME's used?
- What is the main information source?
- For which purpose is the information about other SME's used?
- What are the estimated costs of gathering information about other SME's?
- Which financial statement line items get the biggest attention?

The third part of the questionnaire is directly linked to Chapter 3.4 of the thesis, which analysed the same issues based on literature and prior research. Information about which financial statement line items are most used (i.e. revenue or total assets or something else) can also indicate support to the equity theory – i.e. from whose perspective the financial statements should be prepared, which was discussed thoroughly in Chapter 1.

The fourth part of the questionnaire concentrated on the need for differential reporting between SMEs and was directly linked to Chapter 3.2 of the thesis. It investigated further, what the minimum information needed by the users from SME financial statements would be. The analysis was conducted by dividing the information needs into three parts: information regarding the balance sheet, income statement and notes (including management report). The questions in this section were based on current the EAA and the EASB guidelines. The author outlined in the questions what information companies currently have to disclose according to the law. For example, what the mandatory balance sheet and income statement line items are that have to be included in the annual report according to the EASB guideline number 2. Then the author asked the respondents, which information they currently used and hence, which information should also be included in the SME financial statements in the future. The respondents had also a chance to express their opinion on, what other information should be added or removed from the balance sheet and income statement using a special open-ended question box. In respect of information to be disclosed in the notes, the author composed the question about relevant information by using the EASB guideline number 15 “Disclosures in the notes” and adding additional information from prior studies (Collis *et al.*, 2001; Sian *et al.*, 2009; Cole *et al*., 2012), which outlined data that was considered to be beneficial by financial statement users (such as quality certificates, social responsibility reporting etc.). The aim was to understand what is the information the users and preparers would like to include in the financial statements and to compare it against current legislation, proposed changes (i.e. for changing the Estonian Accounting Act starting from January 1, 2016) and European Accounting Directive 2013/34/EU.

The fifth part of the questionnaire concentrated on the European Accounting Directive 2013/34/EU and aimed to find out the viewpoint of the respondents about the changes proposed in the respective document about SME financial statements. The questions were composed in the format of statements – for example whether the minimum requirements in the Accounting Directive 2013/34/EU for micro entities (assuming the member state would impose these) are considered reasonable or not.

The sixth part of the questionnaire aimed to investigate, whether the SMEs had been engaged in the debate when developing new accounting standards and if not, what the main reasons stopping their participation had been. This part of the questionnaire also included an open-ended question that gave the respondents an opportunity to express their thoughts about SME financial statements and reporting that was not covered by previous questions. This section of the questionnaire was related to Chapter 3.3 of the thesis, which analysed barriers faced by SMEs in realizing the benefits of accounting standards.

The seventh part of the questionnaire included general questions about the respondent – gender, age, occupation, experience (in years) in the field of activity and e-mail address (for receiving the survey results afterwards).

4.2.2. Survey Methodology

The overall aim of the research was to analyse both the existing accounting requirements for SMEs, the users’ perceived needs for different accounting information from other SMEs as well as to outline the SMEs’ own needs as preparers in respect of their financial statements. For this purpose a questionnaire survey method was applied for data collection and the survey subjects were Estonian companies.

The first step in the research was to compose the questionnaire. Questionnaires are more efficient tools for surveying large samples of respondents in short periods of time and because they are more suitable to probability sampling and generalizing to a larger population (Nardi, 2003, 59). The questionnaire was composed of seven blocks of questions described more thoroughly in Chapter 4.2.1. Most questions of the survey were built up providing selected responses (i.e. using close-ended questions), but at the end of most questions, the respondents had the chance to fill in the line “Other”, if the selected answer did not contain a suitable option (open-ended questions). Using close-ended questions is considered to be a more efficient method – it is easier and quicker for the respondents to complete, coding responses is simpler (Nardi, 2003, 65). Open-ended questions allow more variations in people's responses and help to gather their reactions and thoughts on a specific issue. Open-ended are later analysed by doing content analysis, a technique that involves distilling ideas, words, or phrases and coding the according to a system developed (Nardi, 2003, 65). Some of the questions were also constructed with Likert-type scale answers – interval-scale by Stevens classification (Stevens 1946). For every statement, there were five reply options: very good (5), good (4), satisfactory (3), poor (2), bad (1). Some of the questions also included three reply options: "considered reasonable", "not considered reasonable", "hard to say". The latter questions are not viewed as a "typical" Likert-scale, but rather to get peoples initial thoughts and feelings on some statements / issues.

Successful statistical practice is based on focused problem definition. In sampling, this includes defining the population from which the sample is drawn. In the most straightforward cases, it is possible to identify and measure every single item in the population and to include any one of them in our sample. Survey samples can be broadly divided into two types: probability samples and non-probability samples. Statistical theory states that only surveys based on probability samples can be used to create sound statistical inferences about a larger target population. A survey based on a probability sample can in theory produce statistical measurements of the target population that are unbiased and have a measurable sampling error, which can be expressed as a confidence interval, or margin of error. (Nardi, 2003, 99)

The author was not able to create a probability based survey sample according to the fundamental principles of probability sampling by constructing a list of the target population (the sample frame) due to the availability of a single and comprehensive register of Estonian businesses that is freely available and accessible without charges. The Estonian Centre of Registers and Information Systems and Statistics Estonia have databases about companies registered in Estonia, but the information in these databases differs depending on whether the company is economically active, is a non-profit organisation, belongs to the statistical profile etc. Therefore, it is difficult to use this information, and what is more important, the full list is not accessible to third parties. The author also tried to look for a sampling frame which had the characteristic that one can identify every single element and include any in our sample in the context of an Estonian business directory of enterprises with appropriate contact information (for example Äripäeva Infopank), but this was also difficult to access.

However, where it is not possible to use probability sampling, the non-probability sampling at least provides a viable alternative that can be used. As such, it ensures that research following a quantitative research design is not simply abandoned because (a) it cannot meet the criteria of probability sampling and/or (b) meeting such criteria is excessively costly or time consuming, so that it would not be sponsored. This could significantly diminish the potential for researchers to study certain types of population. Non-probability sampling can also be particularly useful in exploratory research where the aim is to find out if a problem or issue even exists in a quick and inexpensive way. After all, one may have a theory that such a problem or issue exists, but there is limited or no research that currently supports such a theory. (Laerd Dissertation, 2015). This is also the case in Estonia, where no surveys have been conducted, among other things, about the needs of SME financial statement users and uses. One may have a theory that different users (by company size group or by users group) have different needs, but until a preliminary survey has not been conducted in that respect, it is difficult to find out if this perception is grounded and whether further analysis (using for example probability sampling) should be conducted.

Whilst a probability sampling technique would have been preferred, the convenience sample (non-probability sampling technique) was the only sampling technique available to collect data. Irrespective of the disadvantages (limitations) of convenience sampling, without the use of this sampling technique, the author would not have been able to get access to any data on SME financial reporting and the users and uses of SME financial statements in Estonia.

To compose the convenience sample, the author used the following resources. The Estonian Centre of Registers and Information Systems (ECRIS) has created a facility to get information about companies for research projects free of charge. But this option has limitations – one can only receive the contacts of 1,000 companies. The author made an application for this by defining the information about 1,000 companies to be provided as follows:

1) Companies registered in Estonia as at 31 December 2013 which are economically active private or public limited entities. As it is possible to get the information only about 1,000 companies, this should be divided as follows:
   - 500 companies – number of employees between 0–9;
   - 400 companies – number of employees between 10–49;
   - 100 companies – number of employees between 50–249.
2) The information about these 1,000 companies should include:
   - registry code;
   - name of the company;
   - e-mail address of the company (as the survey is conducted electronically);
   - phone number of the company;
   - field of activity based on the Estonian Classification of Economic Activities;
   - range of number of employees (0–9, 10–49, 50–249);
   - total revenues for 2013 based on 2013 annual report;
   - total assets as at 31 December 2013 based on 2013 annual report.

The author asked for more contacts for micro companies (with 0−9 employees) and less for small (10−49) and medium sized entities (50−249), because when looking at the statistical profile of Estonian SMEs in 2013, 94% were micro entities, 5% were small entities and 1% were medium-sized entities (Statistics Estonia, 2014b). Dividing the list of contacts to be asked by the company size category, included some quota sampling characteristics to the population (i.e. according to Neuman (2011, 242) identifying relevant categories among the population sampled to capture diversity among units).

When receiving back the contact list of 1,000 companies, the author used number of employees, total revenues and total assets to classify the company as micro, small or medium-sized. Based on the information about total revenues and total assets, it turned out that the final list included 45 micro companies, 644 small companies and 267 medium-sized companies and 44 large companies. As the aim was only to analyse SMEs, the large companies were excluded and the total contact list included 956 companies.

The questionnaire was drafted in a specific electronic environment (justask.ee) and sent by e-mail to the selected respondents using a link to the environment. One benefit of using online questionnaires is that they are set up in a way to allow for instant coding of the data, thereby eliminating a source of error that may occur when researchers enter data from a questionnaire by hand (Nardi, 2003, 60). The survey was launched at the end of November 2014 and was terminated in the end of December 2014. However, response rates tend to be lowest for (e)-mailed questionnaires (Nardi, 2003, 59). Low response rate may seriously affect how accurately researchers can generalize the results to a larger population. Therefore, follow-up e-mail messages, monetary or gift incentives, and other techniques increase the percentage of people who return the questionnaires (*Ibid.*). The author used a follow up-emails and gift incentives to increase the response rate. However, the total responses received from the electronic environment was 43 (response rate: 5%). The author believes that the reasons for this low response rate are of various kinds. One reason for the low response rate was caused by the fact that the questionnaire was to long for online completion (40 questions in total and the average time spent per questionnaire approximately 30 minutes). This is supported by the fact that from the user statistic shown by the electronic environment one can see that approximately 219 people started to fill in the survey, but did not complete it (or have completed it later). If all these people would had finished the survey, the potential response rate would have been 23% or higher, which is considered to be satisfactory for e-mail questionnaires.

As answers by 43 respondents were considered insufficient and it seemed more meaningful to conduct the questionnaire orally, the author engaged 10 bachelor students in the research to conduct additional interviews based on the questionnaire in March and April 2015. The author provided the students with the list of companies contacts received from ECRIS (divided between students), with the aim that the people who were not willing to answer the questionnaire in the electronic environment would be willing to do it orally with a personal approach. The population was enlarged by people who participated in the course of "Professional education courses for chief accountants in Tallinn University of Technology" conducted by Department of Accounting of Tallinn School of Economics and Business Administration in 2014. A list of these people (63 persons) together with the contact information (phone number, e-mail address, company) were provided to the bachelor students as well. The students also had a chance to interview managers and accountants using their connections, but these people and companies they worked for, had to be preapproved by the author and had to meet the criteria of being SMEs.

In total, 50 more questionnaires were completed (by e-mail or in the form of an interview), making the total number of responses 93. The general response rate was still low taking into account the total population (i.e. contacts from ECRIS, TUT course), because when contacting the companies by phone and asking them to participate in the survey, respondents were reluctant to do that due to the following reasons:

- they are not interested in the matter;
- they do not have time to conduct an interview or fill in the questionnaire;
- they are not familiar with the process of preparing an annual report since the accounting documentation is prepared externally by a hired accountant;
- or the questionnaire is too long and it requires high expertise in the accounting matters.

Still, according to Sian and Roberts (2009), prior literature indicates that e-mail surveys typically produce low response rates and that business size and response rates are positively related, however this does not invalidate their use in SME research as a means of interrogating a wide variety of participants (Marriot and Marriot, 1999; Curran, 2000; Curran and Blackburn, 2001).

The results should be interpreted with care taking into account the limitations of the survey (using non-probability sampling, low response rate, etc.), which are more thoroughly discussed in Chapter 4.2.4 "Survey Limitations". Still, considering the diversity and the number of the respondents and taking into account that a similar research has never been conducted in Estonia, the author believes that the responses can be used to get valuable insights who the users of SME financial statements are and whether their information needs are different or not.

4.2.3. Hypothesis, Survey Results and Comparison with Other Surveys

As the aim of the survey was to get both qualitative and quantitative information about the SMEs and their financial statement users. For example, what the main information sources SMEs review when analysing the performance of their competitor are. Or whether the financial statements prepared under the current effective legislation satisfy the needs of different users.

The results are presented using frequency tables that summarize the results of all respondents and for some questions are also divided between the size category of the company – i.e. using the classification of micro, small and medium-sized entities. For questions which were based on Likert-scale, the weighted average scores and where applicable, modes have been calculated. Answers which used interval scales were subject to the analysis using modes and medians. To elucidate the statistical importance of differences in assessments by the mentioned groups, *z*-tests have been carried out. The following hypotheses have been subjected to check (*z*-test):

> <u>Hypothesis 1</u>: the financial statement line items that users of micro companies utilize in analysing the performance of other SMEs are different from those of small and medium-sized companies.
> <u>Hypothesis 2</u>: the financial statement line items that competitors utilize in analysing the performance of other SMEs are different from those of other user groups.
> <u>Hypothesis 3</u>: micro companies perceive the availability, reliability, usefulness and comparability of financial statements differently from small and medium-sized companies.

The total number of answers received was 93, which was divided between micro, small and medium sized companies as follows: 39 answers from micro entity representatives, 40 from small companies and 14 from medium-sized companies. This grouping was made by the author based on the answer to question 1, which asked the respondents to indicate the main financial figures of the company for 2012 and 2013 (including total revenues, total assets and average number of employees) and based on the SME criteria defined in European Accounting Directive 2013/34/EU.

The 93 respondents were divided as follows: 17 male and 76 female respondents. By calculating the mode and median for respective interval scales, one can state that the average respondent was 40–49 years old and had 16–20 years of work experience in his/her field of activity. The division of respondents by occupation is described in Figure 7. The option “other” included a sales director, a management board member etc.). Taking into account the socio-economic background of the respondents, one can conclude that the respondents were adequate to participate in this survey both in terms of having sufficient experience in terms of years and having appropriate qualification and understanding of the matter through their everyday jobs acting mostly as accountants, CFOs and CEOs.

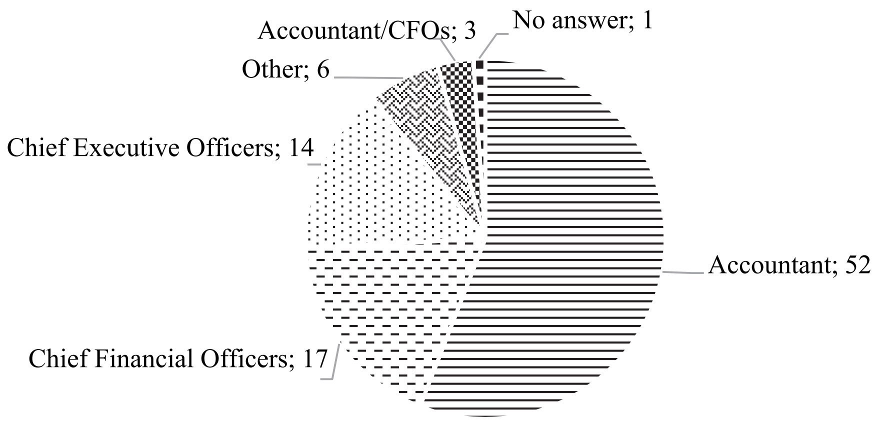

Figure 7. Dividing respondents by occupation (N=93)
Source: composed by the author based on the survey results

Questions 2, 3 and 4 of the survey aimed to analyse the effects of the most recent changes in the Estonian accounting legislation (effective from January 1, 2013) that affected the preparation of the financial statements. As one of the aims of the thesis was to make recommendations for Estonian accounting standard setters, how to amend the current legislation to satisfy the needs of the preparers and users, it was important to find out, how many of the respondents use Estonian GAAP as a basis for preparing their company's annual report. According to the answers received, 87 companies used Estonian GAAP and 6 companies used the IFRSs as adopted by the EU.

From the 87 respondents, who use Estonian GAAP for preparing their company's financial statements, 85 stated that the new EASB guidelines effective from January 1, 2013, had not complicated the preparation of financial statements. One respondent said that preparing the financial statements under new standards was more complicated, because the company the respondent worked for had to keep two separate accounting records and calculations for government grants. As the gross method is no longer allowed under Estonian GAAP, one accounting is kept for the purpose of preparing statutory annual report and the other for providing information to the parent company's financial statements. Another respondent believed that financial statements prepared under new standards required more information to be disclosed in the notes. The latter, however, is not quite true in the author's opinion, because although a separate EASB guideline number 15 was issued that deals with the information to be disclosed in the notes, in general, the amount of data to be included in the appendixes has rather decreased. For example, companies no longer have to disclose changes in Property, Plant and Equipment balances for the comparative period.

The final question of the group aimed to analyse, what changes in the EASB guidelines affected the companies the most. The answers help to understand, whether the EASB should reconsider some of the changes made in the accounting standards. For example, whether we should base some of the accounting principles on the "big IFRS" guidelines and not base them on the IFRS for SMEs. This is important to understand, because the European Accounting Directive 2013/34/EU deals with the financial statement presentation and disclosures and not that much with the accounting principles and the accounting policy choices. The results of question four are presented in Table 24. The table includes answers from 87 companies that use Estonian GAAP when preparing their annual report. Because the respondents had the opportunity to choose multiple answers for this question (in case there were many changes affecting the preparation of the company's financial statements), the total number of answers is 105.

Table 24. Changes in the EASB guidelines (effective from January 1, 2013) that affected the company's financial statements (N=87)

	Micro	Small	Medium	**TOTAL RESPONSES**
Changes did not affect the company	30	24	5	**59**
Accounting for investment property	3	4	3	**10**
Accounting for assets held for sale	2	3	4	**9**
Accounting for government grants	4	3	1	**8**
Accounting for goodwill	0	1	3	**4**
Capitalisation of development costs	0	3	1	**4**
Accounting for financial assets in fair value	1	2	1	**4**
Accounting for associates	1	1	1	**3**
Capitalisation of loan interest	1	1	0	**2**
Accounting for connection fees	0	1	1	**2**
Not presenting third balance sheet when changing comparatives	0	0	0	**0**

Source: composed by the author based on the survey results

The analysis shows that 59 companies out of 87 (68%) that use Estonian GAAP for the preparation of their company's financial statements were not affected by the changes in the EASB guidelines effective form January 1, 2013. The least affected were micro entities – 79%, followed by small companies – 67%. The changes impacted medium-sized entities the most, where 62% of the respondents brought out alterations affecting their financial statements. This is considered reasonable as micro entities are expected to have less complex transactions and one can argue that the changes effective from January 1, 2013 were rather related to some specific / complex accounting area and micro- and small companies to not have these kind of transactions.

The change that affected all the respondents the most, was a change in accounting for investment property. Namely, the change in accounting standards prohibited the companies to use the cost method for accounting for investment property, whose fair value can be determined reliably without undue cost or effort. In April 2014, the EASB decided to add an additional requirement, which also allowed companies to use the cost method in accounting for investment property again. Therefore, it is difficult to say, whether the respondents bore in mind the initial change (effective from January 1, 2013) or they were not aware that another change took place in April 2014 that allowed again the cost method. The latter can be the case as the survey was conducted at the end of 2014 and beginning of 2015. When companies had presented their 2013 financial statements before the change, but had not yet presented their 2014 financial statements, they might not have been aware of the change in the legislation.

The second change affecting the companies the most in new standards was accounting for assets held for sale. Namely, the term "assets held for sale" was removed from the EASB guidelines and starting from January 1, 2013, the companies have to keep accounting for assets held for sale in the same way as they do for other non-current assets.

The third change impacting the preparation of SMEs financial statements the most is accounting for government grants. Under the new EASB guidelines, the gross method is no longer allowed and a new concept was introduced – recording government grant as income when all preconditions are met. The latter change affecting companies is reasonable as well, because many starting companies receive grants from Enterprise Estonia, Eesti Töötukassa etc. For accounting for government grants, the EASB also changed the respective standard in April 2014 by adding additional clarification to the new concept and explaining when the preconditions for recognising government grant are met.

In conclusion to question 4, one can argue that most of the changes introduced in the new accounting standards effective from January 1, 2013 did not have a significant impact on the company's financial statements and the ones that did, have been already changed or amended by the EASB.

Question 5 aimed to find out, what is the main resource, the respondents use to keep themselves up to date with the latest changes in the accounting legislation. This is an important factor to understand, because when introducing new changes to the Accounting Act again, it is important to choose the correct media to take the information about the changes to the financial statement preparers. The summary of the answers is outlined in Table 25. The table includes answers from 87 respondents. Because the respondents had the chance to choose multiple options the total number of answers is 182.

Table 25. Methods companies used to familiarize themselves with the EASB guidelines that came effective on January 1, 2013 (N=87 respondents)

	Micro	Small	Medium	**TOTAL RESPONSES**
Reading the new EASB guidelines	22	24	9	**55**
Participating in training / course	24	21	7	**52**
Reading professional literature covering the subject matter	13	15	8	**36**
Getting information from the company's auditor	0	11	11	**22**
Learning the subject matter in university	2	2	0	**4**
Other	10	2	1	**13**

Source: composed by the author based on the survey results

The option "other" included reading different accounting forums covering the subject matter (8), communicating with other accountants and learning from their experience (3), getting information from the accounting service provider (1) and by giving trainings on the subject matter (1). Getting information from accounting forums is supported by the master thesis of Sonn and Aleksašin (2009), who analysed the usage of internet based accounting forums and concluded that Estonian accountants use them a lot for getting information about a variety of subjects.

Based on the results it is essential to emphasize that for micro and small companies, the most important information sources in respect of accounting changes are respective standards and participation in trainings, whereas for medium-sized entities, the most important information source is the company's auditor. This shows that the companies have good communication with their auditors and they seek advice from auditors on complex accounting issues.

Question 6 examined the expenses companies incur, when preparing and presenting the financial statements. The summary of the answers is outlined in Table 26.

Table 26. Type of expenses companies incur when preparing and filing the annual report (N=93 respondents)

	Micro	Small	Medium	**TOTAL RESPONSES**
Salary of the accountant(s)	21	22	6	**49**
Auditing fees	0	30	14	**44**
Costs incurred in keeping up the IT-systems	8	7	5	**20**
Salary of the chief financial officer (CFO)	1	3	4	**8**
Fees paid to other consultants	3	3	1	**7**
Salary of the chief executive officer (CEO)	1	1	3	**5**
Other	7	4	0	**11**

Source: composed by the author based on the survey results

Table 26 includes answers from 93 people. Because the respondents had the chance to choose multiple options the total number of answers is 144.

The option “other” included answers like: the company does not incur any additional costs (5), some said that the fees paid to accountants and costs related to IT-systems are related to everyday accounting and not specifically to preparing and filing the annual report (3). The latter can also be interpreted that the company does not incur any additional costs. Other respondents said that preparing and filing the annual report requires additional time, but does not give rise to additional costs (2) and one respondent mentioned training expenses (1).

The results are somewhat expected. The expenses directly associated with the preparation and filing of the annual report are the accountant(s) salary and auditing fees. For micro companies the reason is that accounting services are in many cases bought from a service provider and the accounting function (and therefore the fees paid to an accountant) is seen as keeping up with the requirements of the accounting and tax legislation and presenting the annual report to the Commercial Register once a year. For small and medium-sized companies, it is important to emphasize that the most important expense is the fee paid to the company’s auditor – 75% of the small and 100% of medium sized companies brought that up in the responses. This shows that most of the companies in the sample have the obligation to get their financial statements to be audited (except micros). This in turn shows that currently, the limits for being obliged to perform a review or audit may be set at a too low level and should be changed if this requirements imposes to much burden (in monetary terms) on the companies. The latter issue was also analysed using question 7, which asked the respondents to indicate, the expense amount the company incurs in connection with the preparation and filing of the annual report. The answers are outlined in Table 27.

Table 27. Expenses per year the company incurs in preparing and filing the annual report (N=93 respondents)

	Micro	Small	Medium	**TOTAL**
The company does not incur any additional costs	5	0	0	**5**
Up to 100 euros	16	3	0	**19**
Between 101 and 500 euros	12	6	0	**18**
Between 501 and 1,000 euros	4	8	0	**12**
Over 1,000 euros	2	23	14	**39**

Source: composed by the author based on the survey results

The answer to question 7 is in correlation with the answer to question 6. Namely, the small and medium-sized companies incur the highest cost when preparing and filing the annual report, which can be associated with the additional fees they have to pay for the company’s auditor for performing the audit of the annual report. In most cases the fees exceed 1,000 euros. This is somewhat in line with the research of the European Commission, who stated that it costs on average EUR 1,558 per micro company to meet the reporting obligations of the Accounting Directives. It was assessed that without any legal obligations companies would still spend around 25% of that amount to meet their managerial and external information needs. Therefore the remaining 75% or EUR 1,169 is an approximation of the accounting burden these companies face. In the European Union, the total accounting burden amounted to 6.3 billion euros. (European Commission, February 26, 2009).

In Estonia, mostly small and medium sized companies (and not micro companies) incur costs over 1,000 euros for preparing and filing annual reports. Therefore, the administrative burden can be calculated for these companies using the information gathered in question 7. When only using the criteria of the average number of employees (over 10 and less than 249), then according to the statistical profile of Estonian SMEs in 2013, there were 6,919 economically active small and medium sized entities in Estonia (Statistics Estonia, 2014b). Therefore, the minimum administrative burden these companies would incur, if assuming that on average the expenses for preparing and filing the annual report are approximately 1,000 euros, would be 6.9 million euros. It is difficult to conclude whether these costs are low or high – it all depends from whose perspective to review it. For a preparer (a company) these costs may seem high, but from a user's point of view, the importance of the auditor's report or annual report in general cannot be understated. Therefore, the author did not ask the respondents whether they believe that these costs are too high or not.

Question 8 aimed to find out who are the main users of the company's financial statements to whom the company itself provides the financial statements. The results are outlined below in Table 28. The total number of respondents was 93, divided between micro (39), small (40) and medium-sized entities (14). Because the respondents had the chance to choose between multiple options, the table below shows in percentages, how many respondents from that size group picked one or the other answer. For example, 31 micro entities out of 39 respondents (or 79%) see owners as the main user group of the company's financial statements to whom the company itself provides the financial statements.

Prior research (as outlined in Table 3 in Chapter 3.4.1) shows that the main users of SME financial statements are considered to be management, banks and trade creditors. Only a few researches (Sian and Roberts 2009) differentiate between users, who receive financial statements directly from the company, and users, who are considered to use the published financial statements of the company. To the author's knowledge, no prior research has investigated these aspects together in one survey.

Table 28. The main users of the company's financial statements to whom the company itself provides the financial statements (N=93 respondents)

	Micro %	Small %	Medium %	**AVERAGE (%)**
Internal users				
Owners	79%	95%	86%	**87%**
Company's management	49%	80%	93%	**69%**
Other employees of the company	3%	13%	21%	**10%**
External users				
State (including Commercial Register, Tax authorities)	69%	88%	93%	**81%**
Banks and other creditors	26%	70%	64%	**51%**
Trade creditors and suppliers	15%	20%	14%	**17%**
Credit rating agency (*Krediidiinfo*)	8%	15%	0%	**10%**
Potential investors	0%	8%	21%	**6%**
Customers	3%	8%	14%	**6%**
Professional associations	3%	8%	0%	**4%**
Competitors	5%	3%	0%	**3%**
Consultants and financial analysts	5%	3%	0%	**3%**
Other	0%	0%	7%	**1%**

Source: composed by the author based on the survey results

The results of question 8 show that Estonian SME financial statement users, to whom the company itself provides the financial statements, are considered to be the owners, the company's management, state (including Commercial Register, Tax authorities) and banks and other creditors (being mentioned by at least by 50% of the respondents). These results partially coincide with prior research (refer to Table 3 in Chapter 3.4.1), but also show that in Estonia, the owners and the state are considered the main recipients of a company's financial statements. This may be explained by the fact that most of the respondents were either accountants and/or CFOs (not owners of the company) and it is their job to forward the annual reports to the company's owners and/or management (CEOs). In prior research (refer to Table 3 in Chapter 3.4.1), the state itself has not been defined as a separate user, but users such as "tax authorities", "government agencies" etc. have been separately brought out. In Estonia all SMEs have to file their annual report with Commercial Register 6 months after the end of the financial year. This might be one of the reasons why respondents review the state as the main party they provide their financial statements to.

When reviewing the answers of different size groups, then for micro entities, management is not an important financial statement user group. This may be explained by the fact that for many Estonian micro entities owner and manager/management is the same (i.e. the owner is also fulfilling the role of the manager). Another "exception" for micro entities is that banks and other creditors are not considered to be an important financial statement user group. This may be explained if the micro entities do not use external financing for their businesses. However, the latter fact is not supported by the statistical information available from Statistics Estonia database. Namely, according to 2013 information (Statistics Estonia, 2015), companies employing 1 to 9 persons had on average the following balance sheet structure: liabilities 53% of total balance sheet (including short-term liabilities 22% and long-term liabilities 31%), and equity 47% of total balance sheet. On the contrary, companies employing 10 to 49 persons had the following balance sheet structure: liabilities 43% of total balance sheet (including short-term liabilities 25% and long-term liabilities 18%), and equity 57% of total balance sheet. From short-term liabilities, the loan liabilities made up 8% of total balance sheet for companies employing 1 to 9 people and 9% for companies employing 10 to 49 people. The Statistics Estonia database does not specify, what is recorded under long-term liabilities – therefore, it is not possible to analyse and compare the total loan liabilities of the respective size groups and conclude, whether micro companies actually have higher loan obligations. Also, the total amount of companies under investigation was 71,171 and the analysis did not contain companies not employing people (i.e. having zero employees) that are also considered as micro entities according to the criteria set in the Accounting Directive. However, the results of the survey show that the users of micro entity financial statements to whom the company itself provides financial statements are different from small and medium-sized companies. Furthermore, the analysis shows that for small and medium-sized companies, banks are considered to be one essential user group to whom the company itself provides financial information. Although this user group has been well investigated in previous research (Collis *et al.*, 2001; AICPA 2004; Collis 2008 etc), one could carry out a separate survey among the Estonian bankers, to find out what information they use in these financial statements, and more importantly, what additional information they request from the companies. This could provide a valuable insight into understanding the needs of one specific, but important user group in Estonia.

Question 9 aimed to find out the opposite to question 8, namely, who are the main users of the company's financial statements to whom the company itself does not provide the financial statements, but who are perceived to use them. The results are outlined below in Table 29. The total number of respondents was 93, divided between micro (39), small (40) and medium-sized entities (14). Because the respondents had the chance to choose between multiple options, the table below shows in percentages, how many respondents from that size group picked on or the other answer. For example, 28 small entities out of 40 (or 70%) see competitors as the main user group of the company's financial statements to whom the company does not provide the financial statements, but who are perceived to use them anyway.

Table 29. The main users of the company's financial statements to whom the company does not provide the financial statements, but who are perceived to use them (N=93 respondents)

	Micro %	Small %	Medium %	**AVERAGE (%)**
Internal users				
Owners	10%	10%	7%	**10%**
Other employees of the company	10%	10%	0%	**9%**
Company's management	5%	10%	0%	**6%**
External users				
Competitors	51%	70%	64%	**61%**
Credit rating agency (*Krediidiinfo*)	44%	43%	43%	**43%**
State (including Commercial Register, Tax authorities)	46%	20%	14%	**30%**
Trade creditors and suppliers	21%	30%	57%	**30%**
Customers	21%	20%	36%	**23%**
Banks and other creditors	33%	18%	0%	**22%**
Consultants and financial analysts	15%	13%	0%	**12%**
Professional associations	5%	10%	29%	**11%**
Potential investors	0%	20%	0%	**9%**
Other	3%	8%	0%	**4%**

Source: composed by the author based on the survey results

The results of question 9 show that Estonian SME financial statement users, to whom the company does not provide the financial statements, but who are perceived to use them, are considered to be competitors (the only answer being mentioned by at least by 50% of the respondents). It is interesting to note, that prior research (refer to Table 3 in Chapter 3.4.1) has put more emphasis on trade creditors and suppliers and customers as the users of SME financial statements. This coincides with question 14, which asked the respondents if they as users reviewed the financial statements of other SMEs what was the user group they belonged to. The most popular answer was that they reviewed the financial statements of other SMEs as competitors. This is why they believe that their competitors review their financial statements as well. The second and third most popular answer was, that they reviewed the financial statements of other SMEs as customers and trade creditors (refer also to Table 30).

The purpose of question 10 was to find out, what other coercive institutional pressures Estonian SMEs are experiencing in the preparation of the financial statements. Namely, Powell and DiMaggio (1983) observe that as conglomerate corporations increase in size and scope, it is common for subsidiaries to be subject to standardized reporting mechanisms. Subsidiaries most adopt accounting practices, performance evaluations, and budgetary plans that are compatible with the policies of the parent corporation. The results of the survey showed that from micro entities, 2 out of 39 belong to a group, from small entities the ratio was 16 out of 40 respondents and for medium-sized companies, it was 12 out of 14.

Based on the survey, one could argue that in Estonia, the medium-sized companies are the most affected by coercive institutional pressure in the form of potential group accounting policies and rules to follow. To confirm it, it is necessary to further analyse, in which country the parent company of the group is registered and if the group has any group-wide accounting policies in place that are not based on Estonian GAAP. From the 30 respondents stating that their company belongs to a group, 16 entities had their parent company registered in Estonia, five in Finland, four in Sweden, two in the Netherlands, one in Latvia, one in Russia and one in the USA. From the 30 respondents 21 stated that their group had separate accounting policies in place and the company had to prepare a separate set of financial statements based on these rules. In case of 9 respondents, their group policies followed the "big IFRS", for 7 companies Estonian GAAP, 3 respondents stated that their group policies were based on US GAAP and 2 respondents said that the basis of group policies was Finnish GAAP.

To sum up, from the 30 respondents whose companies were part of a larger group, 14 companies or 15% of total respondents, are preparing additional financial statements based on group policies other than Estonian GAAP. Moreover, 8 of these companies are medium-sized, 5 small and 1 is a micro entity. So based on the survey results, one could argue that Estonian medium-sized companies are probably the most affected by possible coercive institutional pressures in the form of group accounting policies. However, when bearing in mind the recent changes in the Estonian accounting standards then until December 31, 2012, Estonian GAAP was based on the "big IFRS". So although differences exist between the two set of standards – i.e. Estonian GAAP and the full IFRS – one of the greatest being that Estonian GAAP required far less disclosure than the IFRSs, then one could argue that the coercive pressure is not that significant for these companies, whose group accounting policies follow the IFRSs. For the other 5 companies (5% of total respondents), which group policies followed US GAAP and Finnish GAAP the coercive pressure is definitely stronger taking into account that the US GAAP differs quite a lot from Estonian GAAP – for example no specific guidance exists under US GAAP for accounting for investment property. Also, some differences exist between Estonian GAAP and Finnish GAAP – the latter only acknowledges operating lease and does not have the term finance lease in their standards. Therefore, differences can arise from preparing financial statements for group financial statements and statutory reporting purposes. Still, when taking into account the results of the survey, the potential impact of different standards and therefore, coercive pressure, is only for approximately 5% of the companies. Therefore, the hypothesis that Estonian companies are subject to coercive pressure is rejected just based on the survey results.

The third part of the questionnaire included more questions about the users and uses of the company's financial statements. The aim of question 14 was to find out the main user group the respondents themselves review and use the financial statements of other companies. The results are outlined in Table 30. The respondents had the chance to choose only one option (total number of answers was 90, divided between micro 37, small 39 and 14 medium-sized entities). 3 respondents did not answer this question.

Table 30. The main user group the respondent belongs to when using the financial statements of other SMEs (N=90 respondents)

	Micro	Small	Medium	**TOTAL**
Competitor	16	18	5	**39**
Customer	10	11	3	**24**
Trade creditor	8	6	4	**18**
Potential investor	1	2	0	**3**
Other	2	2	2	**6**
TOTAL	**37**	**39**	**14**	**90**

Source: composed by the author based on the survey results

The option "other" included answers like: the respondents do not use the financial statements of other SMEs (4), they use it to evaluate subcontractors (1) and all of the above (1) (i.e. as a competitor, customer, trade creditor and potential investor).

The most popular answer among respondents was that they use financial statements as competitors, followed by as customers and as trade creditors. Collis, Dugdale and Jarvis (2001) concluded that 51% of the directors of small companies and 68% of medium-sized companies claim to read the annual report of their major competitors; 44% of small companies and 62% of medium-sized companies claim to read those of their major customers; and 26% of small companies and 36% of medium-sized companies claim to read the annual report and accounts of their major suppliers. The current survey also shows that if the respondents use the financial statements of other SMEs, the main user group they belong to are competitors, followed by customers and trade creditors. Therefore, one can say that the survey results are quite similar to the research conducted by Collis, Dugdale and Jarvis (2001).

The next question aimed to analyse, where users of SMEs financial statements gather information as competitors, customers or trade creditors. The results are outlined below in Table 31.

Table 31. Main sources of information for SME financial statement users (N=86 respondents)

	Micro	Small	Medium	**TOTAL RESPONSES**
Commercial Register	26	32	11	**69**
Internet	20	17	5	**42**
Information received directly from the company	3	7	1	**11**
Professional Association	1	1	2	**4**
Other	3	7	2	**12**

Source: composed by the author based on the survey results

The total number of respondents in Table 31 was 86, because 3 respondents did not answer the question and 4 stated that they did not use the financial statements of other SMEs. Because they had the chance to choose multiple options the total number of answers is 138.

The option “other” only included the answer of credit rating agencies (*Krediidiinfo*). In general it can be said that usually respondents use many sources together, mostly combining information they receive from Commercial Register with their own Internet research (in total 32 respondents from 86).

The next question aimed to find out, the information sources the users utilize to get data about the other SMEs. The results are outlined in Table 32. The total number of respondents was 86 (divided between micro 35, small 38 and medium-sized 13), because 3 respondents did not answer the question and 4 stated that they do not use the financial statements of other SMEs, and the respondents had the chance to choose multiple answers.

Table 32. The source of information for users of SME financial statements (N=86 respondents)

	Micro	Small	Medium	**TOTAL RESPONSES**
Annual report of the company	25	28	12	**65**
Self-made queries and background searches about the company	16	23	3	**42**
Market researches / information from professional associations	4	3	3	**10**
Other	2	4	2	**8**

Source: composed by the author based on the survey results

The option “other” included answers like: credit rating agencies (*Krediidiinfo, Inforegister*, Tax and Customs Board) (7) or market research prepared for that specific company (1).

When comparing the results with prior research then according to Collis, Dugdale and Jarvis (2001), for small companies the three most useful sources of information for management purposes are, in order of importance, the management accounts (management report), the annual report and cash flow information. For medium-sized companies it is the management accounts (management report), cash flow information and budgets respectively. According to the survey, the annual report of the company is considered the most important source of information, which agrees with the research by Collis, Dugdale and Jarvis (2001). The importance of the management report, cash-flow statement and budgets is analysed below in Table 37. Published industry data and information from credit rating agencies were the least important for all companies (Collis *et al.*, 2001). The latter is also similar in Estonia, where market research and information from professional associations and credit rating agencies are used the least according to the survey.

Companies also incur additional expenses when collecting information about SMEs. In respect of micro entities, 21 respondents from 35 (or 60%) stated that they incur additional expenses, when gathering data about other SMEs, for small companies and medium-sized entities the corresponding ratio was 26 out of 38 companies (or 68%) and 12 out of 13 companies (or 92%).

In respect of those respondents stating that they incur additional expenses for gathering information, it was important to find out, what the average cost per year is. The aim was to estimate, whether the costs companies incur are significant and whether this may be an indication that it is expensive, and therefore burdensome for SMEs, to collect information about other companies for business purposes. The results are outlined in Table 33.

Table 33. Expenses per year the companies incur when gathering information about other SMEs (N=86 respondents)

	Micro	Small	Medium	**TOTAL**
The company does not incur any additional expenses	14	12	1	**27**
Up to 50 euros	11	10	2	**23**
Between 51 and 100 euros	7	8	2	**17**
Between 101 and 500 euros	1	3	7	**11**
Over 500 euros	2	5	1	**8**
TOTAL	**35**	**38**	**13**	**86**

Source: composed by the author based on the survey results

Based on the results outlined in Table 33, one could argue that if the companies incur additional expenses for collecting information, the average cost is up to 100 euros pear year. For those respondents answering the questionnaire in the format of an interview or by e-mail (50 respondents), it was also asked, if these expenses were significant for the company and more than half of them stated that they were not. However, this may not be a solid ground to conclude that these expenses are not significant for all company size groups and further analysis is needed.

The next question aimed to find out how often the respondents gather information about other SMEs. The results are outlined in Table 34. The total number of respondents was 85.

The response "other" included: as needed (12), couple of times per month (3) and a couple of times per quarter (1). In total, 37 respondents out of 85 (or 44%) search information about other SMEs at least once a quarter or even more often.

Table 34. Frequency of gathering information about other SMEs (N=85 respondents)

	Micro	Small	Medium	**TOTAL**
Every day	0	3	0	**3**
Every week	1	2	0	**3**
Once a month	4	3	3	**10**
Once in a quarter	8	8	1	**17**
Semi annually	4	5	1	**10**
Once in a year	6	9	2	**17**
Less often	7	1	1	**9**
Other	4	7	5	**16**
TOTAL	**34**	**38**	**13**	**85**

Source: composed by the author based on the survey results

In addition, the author combined answers to questions 18 and 19 into one table to investigate, whether gathering information more often about other SMEs also results in higher expenses. The results are outlined in Table 35. The table shows that most of those companies that incur expenses over 500 euros gather information with the frequency of at least once a month. On the contrary, those companies who search information once a year, incur expenses up to 50 euros.

Table 35. Frequency of gathering information about other SMEs and expenses per year incurred (N=85 respondents)

	The company does not incur any additional expenses	Up to 50 euros	Between 51 and 100 euros	Between 101 and 500 euros	Over 500 euros	**TOTAL**
Every day	0	0	0	0	3	**3**
Every week	1	0	1	0	1	**3**
Once a month	2	2	1	3	2	**10**
Once in a quarter	4	7	5	0	1	**17**
Semi annually	4	3	2	1	0	**10**
Once in a year	6	8	1	1	1	**17**
Less often	4	2	2	1	0	**9**
Other	5	1	5	5	0	**16**
TOTAL	**26**	**23**	**17**	**11**	**8**	**85**

Source: composed by the author based on the survey results

The aim of question 20 was to find out what the main uses of other SMEs financial statements are. The results are outlined in Table 36 below. The total number of respondents was 85 (divided between micro 34, small 38 and medium-sized 13). Because they had the chance to choose multiple options the total number of answers is 143.

Table 36. The main uses of SME financial statements (N=85 respondents)

	Micro	Small	Medium	**TOTAL RESPONSES**
To investigate the solvency of the company	22	36	10	**68**
To compare the financial results of their own company against the competitor operating in the same industry	22	32	13	**67**
To issue short- or long-term loan	0	2	1	**3**
To reorganize the company	1	1	1	**3**
Other	1	0	1	**2**

Source: composed by the author based on the survey results

The option "other" included answers like to evaluate the solvency of a creditor and to evaluate partners. The results are not that surprising – the most common uses include to investigate the solvency of the company and to compare the financial results of their own company against the competitor operating in the same industry. The respondents of this questionnaire are not engaged in loan giving activities.

The next question concentrated on the elements of SME financial statements the users pay most attention to in the review process. The total number of respondents was 86 (divided between micro 35, small 38 and medium-sized 13), because 3 respondents did not answer this question and 4 respondents had stated earlier that they did not use the financial statements of other SMEs. The results are outlined in Figure 8.

The results show that users of SME financial statements use often information about sales revenue, net profit (loss), gross profit (loss), operating profit (loss), and staff expenses – all of these answers were mentioned by at least 50% of the respondents. This shows that Estonian SME financial statement users place great importance on the income statement, which indicates that the users support the entity view of the different equity theories. Namely, the entity view considers the income statement as the primary statement because it enables assessment of performance over the period, and the calculation of dividends for distribution and earnings to be retained in the company (Van Mourik 2014, 33). Entity theory assumes that an additional function is to reconcile the corporation's financial stakeholders conflicting interests by correctly determining income for distribution (Van Mourik 2014, 34). However, when looking together at the answers "often" and "sometimes" instead of gross profit (loss) the users are more interested in loan liabilities (degree of debt).

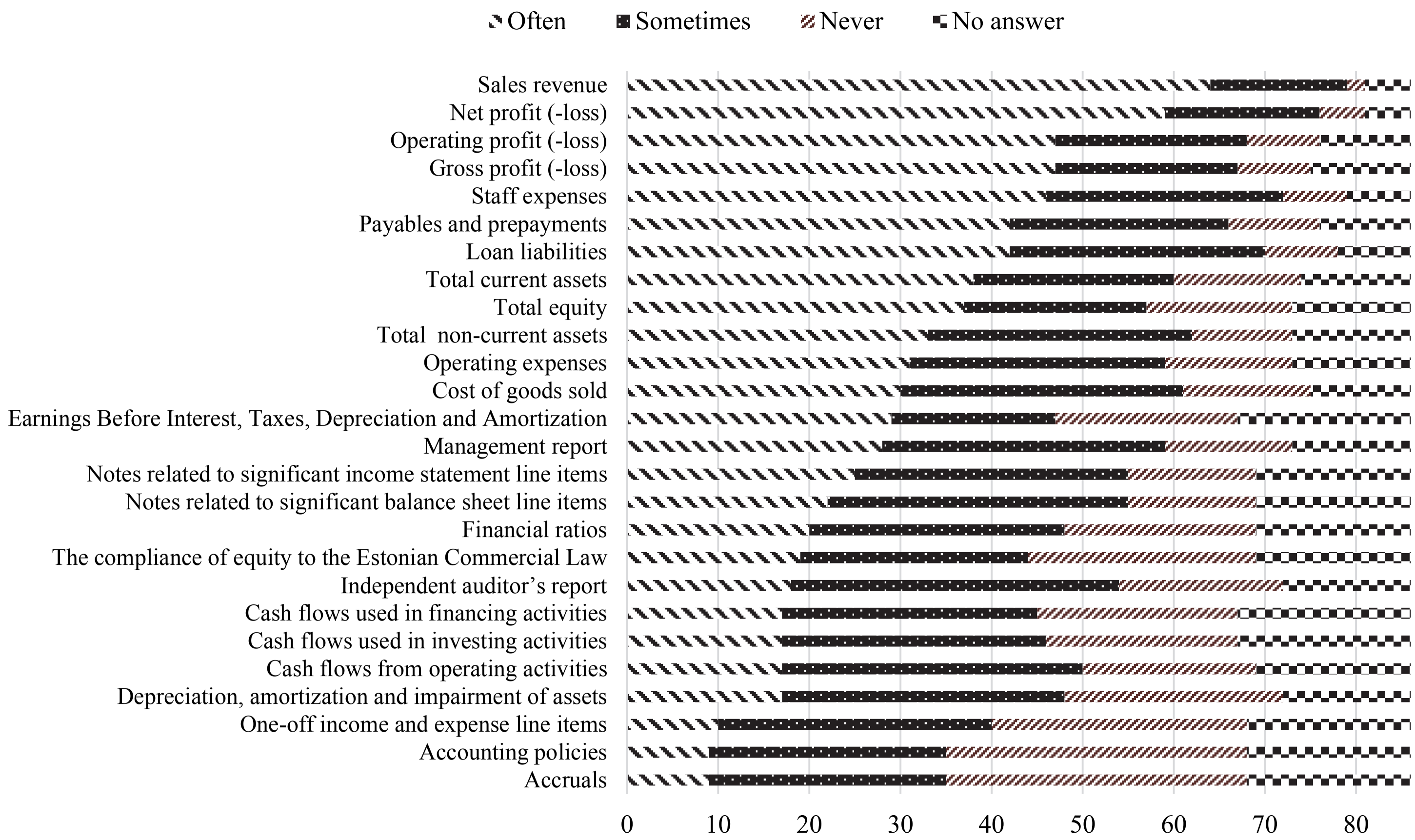

Figure 8. The elements of SME financial statements their users use (N=86 respondents)
Source: composed by the author based on the survey results

When comparing the survey results against prior research, then according to Cole *et al*. (2012) users of financial statements of non-listed companies usually review the following five indicators: sales revenue evolution, net profit, operational profit, (composition of) equity and degree of debt. Three out of five indicators of these results and the author's survey matched when looking at the items that are often used. When reviewing together the answers "often" and "sometimes", the match is even four out of five. In general, one can conclude that the Estonian SME financial statement users seem to attach more importance to the income statement (and related line items) and less on the balance sheet.

On the contrary, 38% of the respondents never use information about accounting policies and accruals. The latter maybe explained by the fact that SMEs do not have accruals in their balance sheet. And the lack in the usage of accounting policies may be twofold – either the accounting policies of SMEs are very straightforward (i.e. assumed that competitors use the same accounting policies as the company) or the users are not sophisticated enough to understand them. Still, choosing one or the other accounting policy can have a significant impact on the total assets and net profit (loss). This is why this part of the financial statements should not be understated.

When comparing the survey results against prior research, then according to Cole *et al*. (2012) it is also important to note that users of financial statements of non-listed companies are least interested in segment information, notes to pensions, information about the shares, corporate governance and accounting policies (Cole *et al*., 2012). In that respect, only the part about accounting policies matched. This is explained by the fact that in the author's survey – answers like segment information and notes to pensions were not included in the options due to the fact that Estonian companies do not have to disclose segment information and do not pay pensions to their employees.

The author has also analysed by company size group, which information is most used by micro, small and medium-sized entities financial statements users. To perform the analysis, the author has assigned a value using 3-point Likert scale to each answer. The option "often" was assigned with value 3, "sometimes" value 2 and "never" value 1. If the respondent did not answer whether they did or did not use one of the financial statement items, this answer was removed from the analysis. Then an average "usage score" for each financial statement line item / component was found using function average in excel. The results are outlined in Table 37.

In addition, the users use information on the company's website (if it exists) and make inquiries about the owner's and management of the company. From financial statements, one respondent also uses information from the related parties note – information about transactions (sales) with related parties.

As already mentioned earlier, the financial statement line items getting the most attention are: sales revenue, net-, gross- and operating profit (loss), and staff expenses.

Table 37. Most used financial statement line items by company size group (average on 3-point Likert scale)

	Micro	Small	Medium	**Average for all respondents**
Sales revenue	2.63	2.82	3.00	**2.77**
Net profit (-loss)	2.42	2.78	3.00	**2.67**
Gross profit (-loss)	2.38	2.56	2.75	**2.52**
Operating profit (-loss)	2.36	2.53	2.83	**2.51**
Staff expenses	2.42	2.50	2.67	**2.49**
Loan liabilities	2.35	2.37	2.83	**2.44**
Payables and prepayments	2.42	2.42	2.42	**2.42**
Total current assets	2.22	2.29	2.67	**2.32**
Total non-current assets	2.15	2.29	2.67	**2.30**
Total equity	2.04	2.36	2.67	**2.29**
Operating expenses	2.14	2.30	2.25	**2.23**
Cost of goods sold	2.17	2.21	2.33	**2.21**
Management report	2.04	2.18	2.58	**2.19**
Notes related to significant income statement line items	1.93	2.17	2.67	**2.16**
EBITDA (Earnings Before Interest, Taxes, Depreciation and Amortization)	1.73	2.21	2.83	**2.13**
Notes related to significant balance sheet line items	1.96	2.07	2.58	**2.12**
Independent auditor's report	1.86	2.06	2.17	**2.00**
Financial ratios	1.78	2.03	2.31	**1.99**
Cash flows from operating activities	2.11	1.79	2.08	**1.97**
Cash flows used in investing activities	2.00	1.82	2.08	**1.94**
Cash flows used in financing activities	2.00	1.79	2.08	**1.93**
The compliance of equity to the Estonian Commercial Law	1.71	2.03	2.08	**1.91**
Depreciation, amortization and impairment of assets	1.71	2.03	2.00	**1.90**
One-off income and expense line items	1.57	1.82	1.92	**1.74**
Accruals	1.58	1.70	1.67	**1.65**
Accounting policies	1.52	1.76	1.67	**1.65**

Source: composed by the author based on the survey results

It was interesting to find out that the statement of cashflows was used sometimes or even never by all size groups (weighted average score below 2 when looking at all size groups together). The author believes that the statement of cashflows is often overlooked and usually misunderstood, but it is a quite critical and integral part of the financial statements. This is supported by the research conducted by Sian and Roberts (2009), who state that „there is less certainty about the advantages of cash flow statements and it has been argued that "there is little evidence suggesting that users at this level find such statements useful". The author believes that the cash flow statement is an integral part of financial reporting that ties the other reports together for a complete picture of a company's financial health. It tells the owners and other financial statement users one very important thing – how much cash the company generates and where it allocates the generated cash. While the cash flow statement is by no means the only method of monitoring cash flows, it should not be overlooked by the financial statement users.

It was also interesting to note that an independent auditor's report was only used sometimes (average score around 2). Although the initial thought is that micro companies do not have audit/review obligation and this is why the score is so low, when looking at the size group answers in more detail one can see that they are not that different. Therefore, the question arises, why the independent auditor's report is not appreciated by the financial statement users. The current survey does not provide a comprehensive answer to that question, but we can only make assumptions. Therefore, the reason why the independent auditor's report is not used is for other research to find out in the future.

The author also performed z-test analysis to investigate, whether micro companies as SME financial statement users place more or less emphasis on some of the financial statements line items than small and medium sized companies. The aim of the statistical analysis was to test Hypothesis 1, which stated that the financial statement line items that users of micro companies utilized in analysing the performance of other SMEs were different from those of small and medium-sized companies.

> $H0$: the needs of micro companies as SME financial statement users are similar to those of small and medium-sized entities
> $H1$: the needs of micro companies as SME financial statement users are different from those of small and medium-sized entities

For the analysis micro companies (max 35 respondents) were reviewed as one group and small and medium sized companies together as another (max 51 respondents). As all the respondents did not answer all the questions, for micro companies the number of respondents was below 30 for some questions and as this is considered to be a small sample, the z-test was replaced by the t-test and critical values were calculated by the author. For performing the t-test, values in Table 37 (the most used financial statement line items by company size group (average on 3-point Likert scale) were used.

The t-test's empirical value on the significance level (α) 5% exceeded the t-test's critical value in case of bilateral hypothesis for the following financial statement line items included in Table 38. For those financial statement line items $H1$ was accepted.

The results in Table 38 show that small and medium-sized companies as financial statement users lay more emphasis on some of the income statement line items than micro entities. They also want to receive more detailed information about different income statement line items. The author believes that this may indicate support towards mandating small and medium-sized companies to draw up a longer income statement and allow micro entities to use the abridged version as described in the Accounting Directive 2013/34/EU and not to draw up notes (at least to the income statement).

Table 38. Financial statement line items on which small and medium-sized companies lay greater emphasis than micro entities

	Number of respondents (micro)	Number of respondents (small and medium)	Critical value[15]	t-test's value
EBITDA (Earnings Before Interest, Taxes, Depreciation and Amortization)	26	41	1.997	3.192
Net profit (-loss)	33	48	1.990	2.889
Notes related to significant profit and loss statement line items	27	42	1.996	2.093
Total equity	28	45	1.994	2.059

Source: composed by the author based on survey results

It is also important to find out if the needs of competitors in respect of what financial statement lines items they are looking at in the annual report differ for example from the needs of customers and trade creditors. To perform statistical analysis, the author has assigned a value using 3-point Likert scale to each answer. The option "often" was assigned with value 3, "sometimes" value 2 and "never" value 1. If the respondent did not answer whether they did or did not use one of the financial statement items, this answer was removed from the analysis. Then an average "usage score" for each financial statement line item / component was found.

The analysis showed that when users looked at the SME financial statements as competitors, they attached the most importance to sales revenue, staff expenses, net profit (loss), gross profit (loss) and operating profit (loss). As clients, the interest is on net profit (loss), sales revenue, operating profit (loss), gross profit (loss) and trade and other payables. As trade creditors the most attention is paid to sales revenue, net profit (loss), gross profit (loss), operating profit (loss) and total equity, and total current assets are not far behind.

The author also performed z-test analysis to investigate, whether competitors as SME financial statement users lay more or less emphasis on some of the financial statement line items than other user groups. The aim of the statistical analysis was to test Hypothesis 2, which stated that the financial statement line items that competitors utilized in analysing the performance of other SMEs were different from those of other user groups.

> $H0$: the needs of competitors as SME financial statement users are similar to those of other user groups
> $H1$: the needs of competitors as SME financial statement users are different from those of other user groups

[15] Calculated by the author using Excel (2010) function T.INV.2T

For the analysis competitors (max 39 respondents) were reviewed as one group and all other users groups (trade creditors, clients etc.) together as another (max 47 respondents).

The *z*-test's empirical value on the significance level (α) 5% exceeded the *z*-test's critical value in case of bilateral hypothesis for the following financial statement line items included in Table 39. For those financial statement line items *H*1 was accepted.

Table 39. Financial statement line items on which competitors pay less emphasis than other user groups

	Number of respondents (competitor)	Number of respondents (other user groups)	Critical value	*t*-test's value
Total equity	34	39	<-1.96…1.96<	-2.969
EBITDA (Earnings Before Interest, Taxes, Depreciation and Amortization)	30	37	<-1.96…1.96<	-2.073
One-off income and expense line items	31	37	<-1.96…1.96<	-2.033
Net profit (-loss)	38	43	<-1.96…1.96<	-2.000

Source: composed by the author based on survey results

The results in Table 39 show that competitors as SME financial statement users lay less emphasis on some of the financial statement line items than other user groups (for example some profit levels). However, the needs in general are not statistically different. As already outlined before, they all review sales revenue, gross profit (loss) and operating profit (loss). The latter however supports the fact that when implementing new Accounting Directive 2013/34/EU, Estonia should not adopt an abridged version of the income statement starting with gross profit (loss) and all user groups are the most interested in the sales figure.

The fourth part of the questionnaire investigated whether users and preparers of Estonian financial statements perceived the need for differential reporting differently, and if they did, whether differential reporting should be implemented to micro-, small, medium-sized and large entities or only for one of them. The total number of respondents was 93, divided into micro 39, small 40 and medium-sized entities 14. The first question of section four aimed to find out, how users and preparers perceived the current accounting framework. The respondents had the chance to express their opinion on 5-point Likert scale where "5" marked "very good" and "1" marked as "bad". The results by company size group and by all respondents are outlined in Table 40, where the number reflects the average score per statement.

Table 40. Evaluation of the current situation regarding SME financial statements in Estonia (5-point Likert scale, 1 bad – 5 very good) (N=93 respondents)

	Micro	Small	Medium	**Average for all respon-dents**
The availability of financial information is:	3.36	3.83	3.57	**3.59**
The reliability and usefulness of financial information is:	3.00	3.40	3.50	**3.24**
The comparability of financial statements of companies operating in the same field of activity:	3.05	3.43	3.43	**3.27**

Source: composed by the author based on the survey results

The results of the survey show that the users and preparers of Estonian SME financial statements believe that the financial information is quite available in Estonia, but the situation with reliability, usefulness and comparability is perceived to be satisfactory (marked with value 3).

Still, the results in Table 40 show that the micro companies tend to believe that the SME financial statements are less available, reliable and useful than small and medium-sized companies. Therefore, the author also performed *z*-test analysis to investigate whether micro companies perceived the current situation regarding SME financial statements in respect of availability *et cetera* differently from small and medium-sized companies. The aim of the statistical analysis was to test Hypothesis 3, which stated that micro companies perceived the availability, reliability, usefulness and comparability of financial statements differently from small and medium-sized companies.

> *H*0: all company size groups perceive the availability, reliability, usefulness and comparability of financial statements in the same way
> *H*1: micro companies perceive the availability, reliability, usefulness and comparability of financial statements differently from small and medium-sized companies

For the analysis micro companies (39 respondents) were reviewed as one group and small and medium-sized companies together as another (54 respondents, divided between 40 small companies and 14 medium-sized companies).

The *z*-test's empirical value on the significance level 5% exceeded the *z*-test's critical value (-1.645…1.645) in case of unilateral hypothesis for all three statements: the availability of financial information (z = -2.308), the reliability and usefulness of financial information (z = -2.555) and the comparability of financial statements of companies operating in the same field of activity (z = -1.938). Therefore, *H*1 was accepted.

This result is an interesting phenomenon that can be explained by many factors. Availability can be explained by the fact that many companies do not present their annual reports to the Commercial register timely. Taking into account the available statistical information, as at October 1, 2015 69% from 140,396 commercial entities have presented their 2014 annual reports to Commercial register (2013: 73%) (Pealinn, 2015). Taking that into account and assuming that most of them are micro entities (as just based on the number of employees micro entities constitute approximately 94% of Estonian companies), the answer in respect of availability is obvious. Also, the question about reliability and usefulness can be explained by many relevant examples – one being that micro entities are not subject to an audit or review. Thus, although under the current accounting law, all companies have to submit the same information, in real life there are differences between the quality of micro entity financial statements and those of small and medium-sized companies.

The analysis of this question showed that users of SME financial statements perceived the availability, reliability and usefulness of the annual report differently. However, should one conclude from this that we should not adopt simplified rules for micro entities included in the Accounting Directive 2013/34/EU as this would hamper the reliability and comparability among size groups even more? The author believes that this is not the case. The availability situation can be improved by introducing more stringent sanctions to the law when companies are being late with presenting their annual reports. The reliability, usefulness and comparability can be addressed by using more uniform reporting forms (which is supported by the use of taxonomy in the preparation of financial statements) and not taking the minimum requirements included in the Accounting Directive for SMEs to the Estonian law. The author is of the opinion that not requesting micro companies to present their management report (which is the intention of the Accounting Directive) would not decrease the usefulness of annual reports even more, because from the personal experience, the management reports of micro companies prepared to date already do not contain information that would be useful for competitor (or other user groups) in the analysis of the SME's activity.

The second question of section four aimed to find out, whether users perceived the need for differential reporting among Estonian companies; differential reporting meaning that different reporting rules should be created for different company size groups. The results are outlined by company size-group and by all 93 respondents in Table 41.

Table 41. Need for differential reporting for companies in Estonia (N=93 respondents)

	Micro	Small	Medium	**TOTAL**
Differential reporting **is not** needed as current Estonian accounting legislation satisfies the needs of all companies	18	17	10	**45**
Differential reporting **is** needed among Estonian companies	21	23	4	**48**

Source: composed by the author based on the survey results

The analysis shows that micro- and small companies believe that differential reporting is needed. Still, agreeing with the statement that differential reporting is needed, is very border-line – 52% of respondents agreeing with it and 48% disagreeing. Based only on this statement, one cannot say that differential reporting should be implemented to the Estonian accounting practice, but further research should be conducted involving more respondents. However, when analysing questions about the new Accounting Directive later on, more evidence is found to support differential reporting among Estonian companies. The most opposed to differential reporting were medium-sized entities, but because this size group only contained 14 respondents, further analysis should be conducted targeting especially medium-sized companies.

From micro entities, those who state that differential reporting is needed, believe it should only be incorporated for micro entities (6), micro- and/or small entities (7), for medium-sized entities (1), for SMEs (2), for micro and large companies (1), only for large companies (1) or for all companies (3).

From small entities, those who state that differential reporting is needed, believe it should only be incorporated for micro entities (5), micro- and/or small entities (8), for micro and large companies (2), for medium-sized and large companies (1), only for large companies (5) or for all companies (2).

In general, micro and small entities believe that only they should be subjected to differential reporting (i.e. reporting less than currently required) – this view was supported by 26 respondents.

From medium-sized entities, those supporting differential reporting, believe it is needed for micro entities (2), micro and small entities (1) and for SMEs (1). Therefore, one could say that medium-sized entities are satisfied with the current accounting legislation applicable to them and see the smaller entities as subject to differential reporting.

The third question of section four aimed to find out, whether users perceived the need for differential reporting among European Union companies. The results are outlined in Table 42.

Table 42. Need for differential reporting among companies in the European Union (N=93 respondents)

	Micro	Small	Medium	**TOTAL**
Differential reporting **is not** needed as each member state should decide independently over the format and presentation of the annual report	22	25	9	**56**
Differential reporting **is** needed among companies registered in the European Union member countries	17	15	5	**37**

Source: composed by the author based on the survey results

What was interesting to note is that when micro and small entities supported differential reporting in Estonia, they did not support differential reporting based on the same rules in the whole European Union. This is very interesting, as it may be an indication of two things – firstly, Estonian SMEs are not engaged in cross-border activities and therefore, do not see value that they may be able to compare the annual reports of themselves and their competitor in Finland or Germany. Secondly, not supporting differential reporting in the EU and believing that each country should establish its own accounting policies may show no support to the new European Accounting Directive. Still, the latter is under further investigation in section five of the questionnaire concentrating specifically on the requirements of the new Accounting Directive 2013/34/EU.

Questions four, five and six of section four concentrated on the minimum information the respondents believe should be disclosed in the SME annual report in order for the users to be able to make decisions on these financial statements. The questions concentrated on the balance sheet, income statement and other items in the annual report. The questions did not cover the cash flow statement and statement of changes in equity, because these are omitted for micro and small companies in the Accounting Directive 2013/34/EU and a separate question, whether this is considered reasonable or not, was included in the sixth section of the questionnaire.

Question four used the balance sheet format as defined in Annex 1 of the effective EASB guideline number 2 "Requirements for Presentation in the Financial Statements". If the respondents indicated that they believed that all the aforementioned balance sheet line items should be included in the annual report's balance sheet, one can argue that they support the current accounting legislation and therefore, the current presentation of the balance sheet. The results are outlined in Table 43.

Table 43. Presentation of balance sheet in the SME financial statements (N=93 respondents)

	Micro	Small	Medium	**TOTAL**
All the balance sheet line items should be disclosed in the annual report	27	30	13	**70**
Some of the balance sheet line items should be disclosed in the annual report	12	10	1	**23**

Source: composed by the author based on the survey results

The results show that most of the respondents believe that the current format of the balance sheet satisfies the needs of SME financial statement users. Those, who think that only certain balance sheet line items should be disclosed in the annual report, believe that the balance sheet format should look like what is included in Table 44. This table was composed by the author using balance sheet line items that were chosen by at least 70% of respondents (N=23, refer to Table 37) who supported a different format of the balance sheet. The balance sheet would mainly include "total" rows and some more specific line items. To make the balance sheet sum up mathematically, line items like “other assets”, “other liabilities” “other equity” should be used.

Table 44. The author’s proposal for the presentation of the balance sheet in the SME financial statements based on the survey results

Cash and cash equivalents
Total current-assets
Total non-current-assets
Borrowings
Total short-term liabilities
Total long-term liabilities
Retained earnings (accumulated loss)
Profit (loss) of accounting year
Total equity

Source: composed by the author based on the survey results

When comparing the potential balance sheet format with the Accounting Directive 2013/34/EU, it is a mix of the requirements for micro- and small-sized undertakings having both “total rows” and also more detailed information such as cash and cash equivalents, borrowings etc.

Question five used the income statement format 1 as defined in Annex 2 of the effective EASB guideline number 2 “Requirements for Presentation in the Financial Statements”. Again, if the respondents indicated that they believed that all the aforementioned line items should be included in the income statement, one can argue that they support the current accounting legislation and therefore, current presentation of income statement. The results are outlined in Table 45.

Table 45. Presentation of the income statement in the SME financial statements (N=93 respondents)

	Micro	Small	Medium	**TOTAL**
All the income statement line items should be disclosed in the annual report	29	30	13	**72**
Some of the income statement line items should be disclosed in the annual report	10	10	1	**21**

Source: composed by the author based on the survey results

The results show that most of the respondents believe that the current format of the income statement satisfies the needs of the SME financial statement users. Those, who believe that only certain income statement line items should be disclosed in the annual report, believe that the income statement format should only include these line items:

- Sales revenue
- Staff expenses
- Profit (loss) of accounting year

This analysis was composed by the author using income statement line items that were chosen by at least 70% of respondents (N=21, refer to Table 37), who supported a different format of the income statement. To make the income statement sum up mathematically, line items like "other income" and "other expenses" should be used. These results are in line with the results in Table 37 and Figure 8, which investigated, which line items are considered to be the most important ones when using and analysing the annual report of other SMEs. The top five items most used according to Figure 8 were sales revenue, net profit (loss), gross profit (loss), operating profit (loss) and staff expenses. When comparing the potential income statement format with the Accounting Directive 2013/34/EU, it bears most similarities with the requirements for micro-sized undertakings including sales revenue. For small and medium-sized entities, the member states had the option to aggregate the rows of sales revenue, variation in stocks of finished goods and in work in progress, work performed by the undertaking for its own purposes and capitalised, other operating income and cost of raw materials and consumables into one section called "Gross profit (loss)". From the survey results it is apparent that sales revenue is in the interest of Estonian SME financial statement users and Estonia should not incorporate this requirement to its accounting legislation.

Question six aimed to find out other information the users of SME financial statements would like to be included in the SME annual report. This question was a combination of some of the current requirements according to Appendix 3 of the Estonian Accounting Act and the EASB guideline number 15 "Disclosure in the Notes" as well information that has been interesting to financial statements users in prior research conducted by other authors (Sian and Roberts 2009; Cole, Branson and Breesch 2012 etc.). The results are summarized in Figure 9. The total number of respondents was 93, who had the chance to choose between multiple options. The most "votes" was given to the number of employees, which information was found useful by 66 respondents.

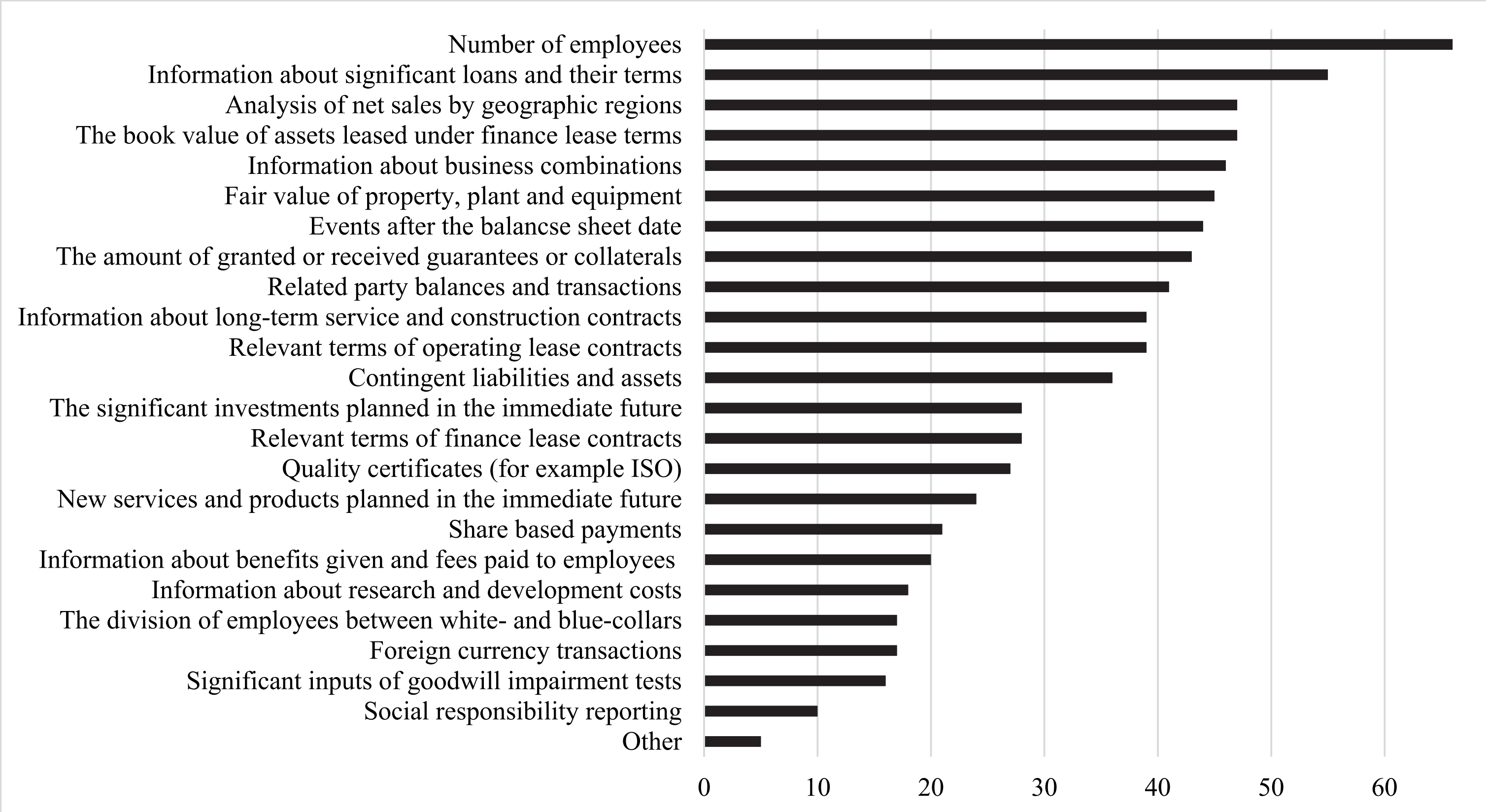

Figure 9. Other information included in the financial statements that is found useful by SME financial statements users
Source: composed by the author based on the survey results

The most popular answers (given at least by 50% of the 93 respondents) were that they would like to see information about the number of employees, information about significant loans and related terms, analysis of net sales by geographic regions and the book value of assets leased under finance lease terms in the annual report. This shows the ongoing interest in sales revenue and staff expenses (already brought out in the income statement analysis in Table 37) and about borrowings – both loans and finance lease (chosen by respondents in the balance sheet analysis in Table 44).

It was interesting to note that the users had little interest in social responsibility reporting, but this may be caused by the fact the respondents may not be familiar with the term (report form) and as the questionnaire was completed mainly online, it was not possible to explain to them what it is either. The little interest in the significant inputs of goodwill impairment tests, foreign currency transactions and research and development costs can be explained by the fact that Estonian SMEs do not have similar transactions – they do not operate in foreign countries or acquire other entities.

The option "other" included a comment that is also quite true – what information is considered to be essential to be disclosed in the annual report of the competitor is not the information that the company itself would like to disclose to its competitors. Some thought that all this information should be disclosed only if required by law – in other cases they would not be willing to give this information to their financial statement users.

The fifth part of the questionnaire concentrated on the new Accounting Directive 2013/34/EU. Firstly, the aim was to find out whether the respondents are familiar with the new Accounting Directive 2013/34/EU or not. In respect of micro entities, 13 respondents from 39 (or 33%) stated that they were familiar with the Accounting Directive 2013/34/EU. For small companies and medium-sized entities the corresponding proportion was 14 out of 40 (or 35%) and 3 out of 14 (or 22%). In total, approximately 1/3 of the respondents had read or heard about the Directive 2013/34/EU.

The second aim was to find out whether the respondents considered the requirements included in the Accounting Directive 2013/34/EU in respect of SME financial statement preparation reasonable or not (described in more detail in Chapter 3.5.1). The respondents were presented with statements that were illustrated with additional information. For example, the statement "Do you consider it reasonable that micro entities have the chance to compile an abridged balance sheet?" was illustrated with the format of the balance sheet included in 2013/34/EU for micro entities. It was also brought out in the questionnaire that these requirements would be applicable if the Estonian government will incorporated some of the simplifications allowed in the Accounting Directive 2013/34/EU to the Estonian law governing SME financial statements. The respondents had to evaluate the statements by marking the statement: considered reasonable, not considered reasonable, hard to say. The results about changes affecting micro entities are outlined in Table 46.

Table 46. Requirements for micro-entities financial statements included in the Accounting Directive 2013/34/EU (N=93 respondents)

	Considered reasonable	Not considered reasonable	Hard to say	**TOTAL**
Opportunity to prepare an abridged balance sheet	66	26	1	**93**
Opportunity to prepare an abridged income statement	67	25	1	**93**
May be exempted from drawing up notes to the financial statements if the following information is disclosed at the end of the balance sheet – the total amount of any financial commitments, guarantees or contingencies that are not included in the balance sheet, the amount of advances granted to members of the administrative, managerial and supervisory bodies, with indications of the interest rates, main conditions and any amounts repaid or written off or waived, and information about transactions with own shares	57	27	9	**93**
May be exempted from the obligation to prepare a management report if information about transactions with own shares is disclosed somewhere in the financial statements	59	19	15	**93**
May be exempted from using the fair value system of accounting	23	29	41	**93**
May be exempted from the obligation to publish annual financial statements provided that the balance sheet information contained therein is duly filed in accordance with the national law	43	37	13	**93**

Source: composed by the author based on the survey results

In respect of micro entities' financial statements, the results show that respondents strongly agree with the option to prepare an abridged balance sheet, and abridged income statement and the exemption from drawing up notes and a management report. The opinions are mixed in respect of fair value accounting, where approximately 44% of the respondents did not know what to think about it. The opinions were very borderline about the opportunity of exempting micro entities from the obligation to publish only the balance sheet to Commercial Register.

Similar principles for micro entities were also applied when asking the opinions of respondents to small entities' financial statements. The results about small entities are outlined in Table 47.

In respect of small entities' financial statements, the results are more borderline – the respondents agree with the option to prepare an abridged balance sheet, but they do not consider the abridged income statement format reasonable. Stronger support is given to the exemption of drawing up limited number of notes to the financial statements and not presenting management report. But the respondents are against the opportunity for the Member States to exempt small undertakings from the obligation to publish their income statement and management reports, they would rather prefer that small undertakings had to file to the Commercial Register an abridged balance sheet, an abridged income statement, a management report and a limited number of notes to the financial statement.

Table 47. Requirements for small-entities financial statements included in the Accounting Directive 2013/34/EU (N=93 respondents)

	Considered reasonable	Not considered reasonable	Hard to say	**TOTAL**
Opportunity to prepare an abridged balance sheet	49	37	7	**93**
Opportunity to prepare an abridged income statement that starts with gross profit (loss)	41	46	6	**93**
Are required to present only a limited number of notes to the financial statements (including accounting policies adopted, revalued amounts of fixed assets, financial instruments and/or assets other than financial instruments are measured at fair value, the total amount of any financial commitments, guarantees or contingencies that are not included in the balance sheet, the amount of advances granted to members of the administrative, managerial and supervisory bodies, the amount and nature of individual items of income or expenditure which are of exceptional size or incidence; the average number of employees during the financial year)	60	20	13	**93**
May be exempted from the obligation to prepare a management report, when information about transactions with own shares is disclosed in the financial statements, or if they prepare a management report, they are not obligated to include financial information	55	22	16	**93**
Have to file to the Commercial Register only an abridged balance sheet, an abridged income statement, a management report and a limited number of notes to the financial statement	45	29	19	**93**
Member States may exempt small undertakings from the obligation to publish their income statement and management report	21	51	21	**93**

Source: composed by the author based on the survey results

The Accounting Directive 2013/34/EU does not require for the SMEs to prepare and present the cash flow statement and the statement of changes in equity either. The summary of the results is outlined in Table 48. The respondents considered both options – not to present and prepare the cash flow statement and the statement of changes in equity – reasonable.

Table 48. Requirements for SME financial statements included in the Accounting Directive 2013/34/EU (N=93 respondents)

	Considered reasonable	Not considered reasonable	Hard to say	**TOTAL**
SMEs do not have to prepare and present the cash flow statement	49	32	12	**93**
SMEs do not have to prepare and present the statement of changes in equity	41	40	12	**93**

Source: composed by the author based on the survey results

Looking at the same questions by company size class, 54% of micro companies and 58% of small companies consider it reasonable not to present the cash flow statement. But from medium-sized companies (total 14 respondents), 36% consider it reasonable, 43% have the opposite opinion and 21% do not know what to think.

In respect of the statement of changes in equity, the support not to present it comes from micro entities. 50% of small companies and 50% of medium-sized entities are of the opinion that losing the statement of changes in equity is not reasonable. Therefore, further analysis in needed to find out, if losing both statements from the complete set of financial reports is reasonable or not.

In May 2015, the Estonian Ministry of Finance sent the draft bill of Estonian Accounting Act that takes into account the changes in the Accounting Directive 2013/34/EU and comes effective starting from January 1, 2016 for consulting with other Ministries. According to the Draft Bill, Estonia has defined the following companies' size groups included in Table 49.

Table 49. Size categories of micro-, small and medium-sized entities based on the Draft Bill of Estonian Accounting Act 15-01272-2

	Medium-Sized Entity	Small-Sized Entity	Micro-Sized Entity
Criteria	Entities which, on their balance sheet date, do not exceed the limits of two of the following three criteria: a) balance sheet total of not more than € 20,000,000; b) net turnover of not more than € 40,000,000; c) average number of employees during the financial year not more than 250.	Entities which, on their balance sheet date, do not exceed the limits of two of the following three criteria: a) balance sheet total of not more than € 4,000,000; b) net turnover of not more than € 8,000,000; c) average number of employees during the financial year not more than 50.	Entities which, on their balance sheet date, are in compliance with all of the following criteria: a) balance sheet total of not more than € 175,000; b) total liabilities do not exceed total equity; c) one shareholder who is also member of the Management Board and not liable to value added tax (VAT).

Source: composed by the author based on the Draft Bill of Estonian Accounting Act 15-01272-2 (issued in May 2015)

Large companies are companies exceeding the thresholds set for medium-sized entities. The term “nano entities”[16] which was initially included in the intention of developing the draft (Estonian Ministry of Finance 2014a) has been removed from the Draft Bill (Estonian Ministry of Finance 2014b). In general, when the thresholds set for small and medium-sized entities follow the criteria set in Accounting Directive 2013/34/EU, for micro entities, the criteria have been changed quite a lot.

Firstly, Estonia has halved twice the total balance sheet amount – in the Directive 2013/34/EU it was set at 350 000 euros. Secondly, Estonia has introduced new quantitative criteria in the form of total liabilities – namely, the latter cannot exceed 50% of the total balance sheet (i.e. has to be less than total equity). Thirdly, Estonia has introduced new qualitative criteria which says that the company can only have one shareholder, who is also a member of the Management Board and is not be liable to value added tax (VAT). This automatically eliminates those entities that in all other aspects meet the criteria but just have two shareholders from the micro entities group. Also, the definition used in the Draft Bill of Estonian Accounting Act does not include direct reference to total sales that in the Directive 2013/34/EU was set at 700,000 euros. However, by stating that a micro entity cannot be liable for VAT, automatically means that the revenues of the company cannot be higher than 16,000 euros according to the VAT Act.

[16] For more information about the term “nano entities” refer to Chapter 3.5.2.5.

The author has also analysed the requirements for the preparation and publication of the annual report for SMEs included in the Draft Bill. The summary of the requirements is included in Table 50.

Table 50. The requirements for the preparation and publication of the annual report for SMEs based on the draft bill of Estonian Accounting Act 15-01272-2

	Framework	Preparation of the annual report	Publication of the annual report
Large company	IFRS [17]/ Estonian GAAP [18]	4 main financial reports + approx. 15 notes + management report	Requirements do not change compared to the current law
Medium-sized company	IFRS / Estonian GAAP /	4 main financial reports + approx. 15 notes + management report	Requirements do not change compared to the current law
Small company	Estonian GAAP	Balance sheet, income statement + 9 notes + management report	Balance sheet, income statement + 9 notes + management report
Micro company	Compliance Framework [19]	Balance sheet, income statement + up to 3 notes	Balance sheet, income statement + up to 3 notes

Source: composed by the author based on the Draft Bill of Estonian Accounting Act 15-01272-2

Comparing the current Accounting Act, Draft Bill, Accounting Directive 2013/34/EU and the survey results in respect of micro entities, one can say that there are significant changes compared to the current Accounting Act and Draft Bill of Accounting Act. In respect of Draft Bill of Accounting Act and Accounting Directive 2013/34/EU, one can say that Estonian government has adopted most of the requirements and some of the exemptions allowed. The greatest differences are that Estonia requires for the micro entities to prepare a longer income statement (similar to the version that is currently required under the effective Accounting Law) and when the Accounting Directive provided an exemption for micro entities to only file an abridged balance sheet (Article 36, 1 d)) than Estonia requires for the companies to submit an abridged income statement as well. The full results of the analysis are included in Table 51.

[17] IFRS as adopted by the European Union

[18] Estonian GAAP (Estonian good accounting practice, starting from 2017 Estonian Financial Accounting Standard)

[19] The annual report of a micro company only includes information that is required by law. Therefore, the financial statements of micro companies do not to give a true and fair view of the financial position, financial performance and cash flows of the company and are not a sufficient information source for users with financial knowledge to use as a basis of economic decision-making process.

Table 51. Requirements in respect of micro entities financial statements included in the current Accounting Act, Draft Bill, Accounting Directive 2013/34/EU and survey results

Micro entities	Accounting Act (effective till 31 December 2015)	Draft Bill of Accounting Act (effective from 1 January 2016)	Accounting Directive 2013/34/EU	Survey Results
Balance sheet	Required	Abridged balance sheet (current assets, non-current assets, short-term liabilities, short-term provisions, long-term liabilities, long-term provisions, capital and reserves, subscribed capital unpaid). Estonia has used the exemption not to present "Prepayments and accrued income" and "Accruals and deferred income".		Support an abridged balance sheet
Income statement	Required	Income statement by nature of expenses (sales revenue, other operating income, variation in stocks of finished goods and in work in progress, work performed by the undertaking for its own purposes and capitalised, cost of goods sold, operating expenses, staff costs, depreciation, value adjustments, other operating expenses, finance income and expenses (very detailed), tax, profit or loss).	Abridged income statement by nature of expenses (sales revenue, other income, cost of raw materials and consumables, staff costs, value adjustments, other charges, tax, profit or loss)	Support an abridged income statement of Accounting Directive 2013/34/EU
Cash flow statement	Required	Not required	Not required	Support not to present a cash flow statement
Statement of changes in equity	Required	Not required	Not required	Scarcely support not to present a statement of changes in equity
Notes to the annual report	Required (accounting policies, material items related to main statements,	Required (1) the total amount of any financial commitments, guarantees or contingencies that are not included in the balance sheet, 2) the amount of advances granted to members of the administrative, managerial and supervisory bodies, with indications of the interest rates, main conditions and any amounts repaid or written off or waived, and 3) information about transactions with own shares) – up to 3 notes		Support a smaller number of notes

	other) –approx. 10-15 notes			
Management report	Required	Not required	Not required	Support not to prepare a management report
Publication of annual report	Four main statements and notes and management report	Main statements (abridged balance sheet and income statement) and up to 3 notes	As a minimum requirement file a balance sheet and information disclosed at the foot of the balance sheet	Scarcely support to present only a balance sheet

Source: composed by the author based on the respective documents

Comparing the current Accounting Act and Draft Bill in respect of requirements affecting small entities (refer to Table 51), one can say that there are some changes, but these are not as significant as for micro entities. The small companies are given the opportunity to use an abridged balance sheet, but they are allowed to fill in additional information. This information is similar to what is required in the Accounting Directive for medium-sized and large companies. The abridged version of the balance sheet is similar to what is included in the Accounting Directive. Looking at what the respondents of the survey preferred, 53% of the respondents favoured an abridged balance sheet. As 40% of the respondents did not support the abridged format of the balance sheet, it is good that the Draft Bill gives the small companies the opportunity to disclose more information in case wanted.

The income statement format in the Draft Bill is the same as in the Accounting Directive and Estonia does not use the opportunity for small and medium-sized entities to start the income statement with gross profit (loss) that is an exemption allowed by the Accounting Directive. This is somewhat in line with the survey results, which show that 49% of the respondents did not support the abridged version of the income statement. As 44% of the respondents supported it and 7% did not know what to think about it, this may be an area, where further investigation is needed. On the other hand, when looking at the survey results in general, then Estonian SME financial statement users place the most importance on sales revenue, which shows that when "removing" this information from the financial statements, the users will lose important information.

For the cash flow statement and statement of changes of equity, the Draft Bill follows the guidelines of the Accounting Directive (i.e. they are not required for small companies) and this is also in line with the survey results. The same applies to notes to the financial statements of small companies, where the Draft Bill follows the principles included in the Accounting Directive and provides many simplifications for the smaller companies. Again, composing fewer notes and thereto, disclosing less information, is in accordance with the survey results.

In respect of the management report, the Draft Bill includes the requirement to compose the latter document although the Accounting Directive included an exemption for small companies that they do not have to prepare the management report, if information about transactions with own shares is disclosed in the financial statements. Or if they prepare a management report, they are not obligated to include financial information. Looking at the survey results, 59% of the respondents supported the simplification included in the Accounting Directive that small companies should not present a management report. In this regard, the Draft Bill is not in line with what users and preparers want.

When it comes to the publication of the annual report, in this case Estonia has also chosen not to incorporate the exemptions of the Accounting Directive to the new Accounting Act. Looking at the survey results, 48% of the respondents supported filing only an abridged balance sheet, an abridged income statement, a management report and a limited number of notes to the financial statements to the Commercial Register, and 55% were against using the allowed exemption that small companies do not have to file the income statement and notes. So in this matter, it seems that Estonia has made the right choices when incorporating the requirements of the Accounting Directive to the new Accounting Act. The full analysis is also included in Table 52.

For medium-sized entities the requirements Estonia is incorporating into the new accounting law (as described in the Draft Bill), are similar to what is required by the Accounting Directive (refer to Chapter 3.5.1). Estonia does not include any exemptions allowed by the Accounting Directive into the new EAA (for example starting the income statement with gross profit (loss)).

In general, Estonia is rather on the conservative side when looking at what will be implemented in the new Accounting Act compared to what exemptions are allowed in the Accounting Directive 2013/34/EU. This, however, should not come as a surprise, because initially, the Estonian government submitted a claim to the European Court of Justice for the annulment of some provisions in the Accounting Directive 2013/34/EU. In the opinion of the Estonian government, the Accounting Directive did not serve its objectives and they could not be achieved and the transposition of the Directive would affect the transparency of economic space and competitiveness of enterprises. Estonia has also found some “loopholes” in the Accounting Directive by giving small companies the chance to present more information if they want to – with that Estonia is still in line with the European Union law, but achieves its goal to get more information from the small companies. With respect to micro companies, the author believes that Estonia has changed the criteria for a micro company quite significantly for the companies to qualify as one. This pushes more companies out of the micro company size group into the small company size group and in there, the rules are different and more similar to what we have been used to see in an annual report (including the “longer” balance sheet, a management report, more notes). When Looking at how the Estonian companies are divided into different size groups based on 2013 data and criteria described in the Draft Bill, the total number of enterprises is 115,128, which is divided between: micro 16,512 (14.34%), small 98,139 (85.25%), medium 406 (0.35%) and large 71 (0.06%) (Draft Bill of Estonian Accounting Act, 2015). There is no information publicly available about how the companies would be divided in Estonia if using the size criteria included in the Accounting Directive 2013/34/EU. One can only use the information about the average number of employees and based on the data of Statistics Estonia (2014b) the statistical profile of Estonian SMEs in 2013 was as follows: 94% were micro entities, 5% small entities and 1% medium-sized entities (the total number of companies 112,578). Although the number of companies differs – i.e. what is stated on the database of Statistics Estonia and what is included in the Draft Bill of Estonian Accounting Act – it still gives some overview of how “manipulating” with the criteria and the definition of micro companies has helped to shift most of them to the small company category.

Table 52. Requirements in respect of small entities' financial statements included in the current Accounting Act, draft bill, Accounting Directive 2013/34/EU and survey results

Small entities	Accounting Act (effective till 31 December 2015)	Draft Bill of Accounting Act (effective from 1 January 2016)	Accounting Directive 2013/34/EU	Survey Results
Balance sheet	Required	Abridged balance sheet – refer to the information included in Table 5 in respect of small entities); or allowed to use "normal" balance sheet as required under the current Accounting Act	Abridged balance sheet – refer to the information included in Table 5 (in respect of small entities)	Support an abridged balance sheet
Income statement	Required	Income statement by nature of expenses – refer to the information included in Table 51 in the same column (in respect of micro entities)	Income statement by nature of expenses – refer to information included in table 48 in respect of small entities; <u>an abridged version</u>: allowed to start with gross profit (loss) (refer to the information included in Table 6 in respect of small entities)	Do not support an abridged income statement of Accounting Directive 2013/34/EU starting with gross profit
Cash flow statement	Required	Not required	Not required	Support not to present a cash flow statement
Statement of changes in equity	Required	Not required	Not required	Scarcely support not to present a statement of changes in equity
Notes to the annual report	Required (accounting policies, material items related to main statements, other) – approx. 10-15 notes	Required to present only a limited number of notes to the financial statements (including accounting policies adopted, revalued amounts of fixed assets, financial instruments and/or assets other than financial instruments measured at fair value, the total amount of any financial commitments, guarantees or contingencies that are not included in the balance sheet, the amount of advances and credits granted to members of the administrative, managerial and supervisory bodies, the amount and nature of individual items of income		Support a smaller number of notes

		or expenditure which are of exceptional size or incidence; the average number of employees during the financial year etc.) – up to approx. 9 notes		
Management report	Required	Required	May be exempted from the obligation to prepare a management report	Support not to prepare a management report
Publication of annual report	Four main statements and notes and management report	Balance sheet, income statement and 9 notes and management report	File to the Commercial Register only an abridged balance sheet, an abridged income statement, an abridged management report and a limited number of notes to the financial statements; exemption allowed for not filing the income statement and notes	Scarcely support to present what is required by Accounting Directive 2013/34/EU; do not support the allowed exemption

Source: composed by the author based on the respective documents

The sixth part of the questionnaire investigated, whether the respondents had participated in the standard setting process and if they had not, what the main reasons were. Nobody from the 93 respondents had ever participated in the standard setting process or made proposals to the EASB in respect of new guidelines. The results about, what the reasons hindering the participation process were, are outlined in Table 53. The total number of respondents was 93 divided between micro 39, small 40 and medium-sized 14 companies. As respondents had the chance to choose multiple options, this made the total number of answers to 186.

Table 53. The reasons hindering the participation process of SMEs in the standard setting process (N=93 respondents)

	Micro	Small	Medium	**TOTAL RESPONSES**
SMEs do not realise that they can actively participate in and influence the development process	18	21	6	**45**
Lack of resources (money, time, skills and knowledge)	12	17	10	**39**
Belief that the participation of SMEs is not needed, because the decisions are based on what the government wants	15	17	5	**37**
SMEs are not aware of the importance of participation or its potential benefits	12	19	5	**36**
Belief that the participation of SMEs is not needed, because the decisions are based on what large companies want	13	10	2	**25**
Other	2	1	1	**4**

Source: composed by the author based on the survey results

The other reasons, why respondents had not participated in the standard setting process, included: not considered necessary (2), there are no reasons (1) or the people engaged in the standard setting process are competent enough so there is no need for further involvement by SMEs.

Based on the answers, it can be stated that almost half of the respondents (45 or 49%) are not aware that they can actively participate in and influence the development process. This shows that the government and other respective organisations could contribute more to outreach activities among interested parties and invite them to comment more on the proposed standards and laws. As a reminder, when the EASB was developing new accounting standards based on the IFRS for SMEs that were adopted on December 30, 2011 and came effective starting from January 1, 2013, only approximately 10 companies sent their comment letters to the EASB to make proposals on which accounting principles should be allowed and how they should be applied (Vilu, 2012). Maybe one of the reasons for the low participation rate in Estonia is the lack of awareness that can easily be overcome. But from these 45 respondents, 18 also stated that they would not have the resources (money, time, skills and knowledge) to participate. Thus, even if the government invested in the outreach activities to familiarize interested parties about the upcoming changes, this could be hindered by the lack of resources of interested parties. The author believes that the most scarce resource may even be skills and knowledge. This is based on the observation of different factors and also supported by the survey results. For example, when respondents were asked whether they knew that the European Union had released a new Accounting Directive and whether they were familiar with it, approximately 1/3 of the respondents stated that they did. Thus, if companies (and accountants, CEOs, CFOs working there) do not know the upcoming changes 1.5 years after the publication of the respective Directive, one cannot expect them to have an opinion of the subject matter and initiate a debate in society on which requirements should be adopted to Estonian Accounting Act and which should not be. However, this does not mean that we should neglect SMEs from the standard setting process due to the fact that they are not so sophisticated in the accounting and financial reporting matters. The state should come up with some measures, how to overcome this obstacle. Further ideas in this matter are included in the "Recommendations" chapter.

The sixth part of the questionnaire also gave respondents an opportunity to bring out any other thoughts regarding SME financial reporting (i.e. how they should be compiled and what should be included in them). The most interesting ideas brought out by the respondents were:

- As a minimum, each company's financial statement should include a balance sheet and an income statement;
- There is no need for a management report – this information presently included there can be easily added to the notes of the financial statements;
- Micro entities should not be obliged to present their annual report to Commercial Register;
- There is no need to include cash flow statement in the annual report, because it does not give valuable information and is often "put together";
- The balance sheet and income statement formats in the annual report should be more detailed as then there would be no need to compose additional notes related to these statements;
- Additional disclosure requirements in the notes of the financial statements should be dependant not on the size of the company, but rather on the field of activity;
- The content of a SME annual report should depend on the transactions the company has entered into during the year. Compiling the annual report should start by declaring the transactions and based on that the systems tells if the company should only present abridged financial statements or if additional information should be disclosed in the notes. For example, if the company has interest income or expense, this would mean an additional note about the borrowing and related terms. Or if the company has filled in the declaration of income and social tax, unemployment insurance premiums and contributions to mandatory funded pension in the systems of Estonian Tax

and Customs Board during the year, they are automatically obliged to provide information about staff expenses and the number of employees in the notes.

Some of the respondents brought out bigger issues in the current accounting practice which, if ought to be implemented, require amending not only the accounting law but other laws as well. For example the government should decrease the labour taxes for micro entities in order to help them increase profit and invest it in the development of the company. Just changing the accounting law and with that minimizing the "accounting burden" does not create additional value. One respondent believed that owners-managers of Estonian micro entities are the accountants of the company as well, but most of them are not that familiar with accounting principles and rules (including what is and what is not business related expense). Therefore, if the government changes the accounting law and does not require a full set of financial statements (i.e. annual report) in the future, the situation will become even worse and the financial statements would be very "amateur" – numbers just put together in a form not considering the substance behind them.

There were few respondents, who believed that the system in place for compiling and presenting annual reports in Estonia through the system developed by Estonian Centre of Registers and Information Systems should remain, including the current format of the annual report. But there were also people who emphasized that they cannot wait for the government to implement the changes required by Accounting Directive 2013/34/EU for SME financial statements.

4.2.4. Survey Limitations

This research is set within the context of changing accounting regulation for SMEs at the international level (the IASB guidelines), regional level (the EU new Accounting Directive 2013/34/EU) and local level (Estonian new Accounting Act). The aim of the research is to assess the utility and usefulness of potential guidelines, through the use of e-mail questionnaires sent to SMEs. Although the study is subject to key limitations described in more detail below, the data presented here provide a useful insight into the financial reporting needs of SMEs and the users and uses of their reports and the results have implications for Estonian and international regulators intending to issue new regulatory guidance for these entities. For example, when the Estonian Ministry of Finance conducted a survey in spring 2014 about the "Changes in Accounting in 2014-2017" the survey also had many limitations (that were not brought out in the survey), but it was still used to develop the Draft Bill of the Accounting Act (also taking into account the comments received on round table meetings with affiliated groups). From reading the survey report, one can bring out the following limitations – the survey used convenience sampling to receive answers. Initially, the survey was sent to appropriate (convenience) respondents by e-mail providing link to the questionnaire conducted in the respective internet-based tool (Survey Monkey). The total population was not defined and in total 95 people responded to that survey.

The author recognises that her survey, like most of the studies concerning users, has some limitations. Firstly, the sample is not constructed by means of probability sampling. As it was not possible to construct a probability sample, non-probability sampling technique was used. But with non-probability methods one can only make conclusions about those who have completed the survey (Nardi, 2003, 106). The convenience sample included respondents from the contact list provided by ECRIS and enlarged by people who participated in the course of "Professional education courses for chief accountants in Tallinn University of Technology" conducted by Department of Accounting of Tallinn School of Economics and Business Administration in 2014 and by contacts of the bachelor students helping to carry out the study. The companies included in the survey met the size-criteria (i.e. being SMEs) and also included people with relevant skills and expertise to answer the questions (accountants, CFOs, CEOs). Therefore, the author believes that the survey still targeted relevant parties to fulfil the aim of the research – get an insight into the financial accounting policies and procedures about Estonian SMEs, receive information about the users and uses of SME financial reporting in Estonia, get reactions about the proposed changes to the accounting legislation in the European Union Accounting Directive 2013/34/EU and investigate other issues and problems of SME financial reporting that can be subject to further surveys in the future.

Secondly, although the study is subject to a relatively low response rate, the data presented here provide a useful insight into the financial reporting needs of SMEs and the users and uses of their reports and the results have implications for Estonian and international regulators intending to issue new regulatory guidance for these entities.

Thirdly, the survey only included 14 responses from medium-sized companies. Therefore, one could say that this group was underrepresented to compare it with micro and small entities and draw grounded conclusions about this size-group separately. Still, this does not diminish the value of the survey in general to provide insight into the SME financial reporting.

4.2.5. Recommendations

In this chapter the author has included the recommendations to be given to the Estonian Ministry of Finance and Estonian Accounting Standards Board in respect of current accounting legislation.

4.2.5.1. Definition of Micro-, Small- and Medium-Sized Entities

When reviewing the definition of SMEs, Estonia has accepted in the Draft Bill of the new Accounting Act the criteria set in the Accounting Directive 2013/34/EU, except for micro entities, for which we have defined our own quite unique version. The author intentionally uses the word "unique", because when comparing this definition of micro entities to the legislation adopted in other European Union member countries, differences occur. Based on the available literature and information included in Chapter 3.5.2 of the thesis, there are only a few countries (for example Slovenia and Spain) who have also defined micro entities. The definitions used by these countries follow only the quantitative criteria and are similar to the definition included in the Accounting Directive 2013/34/EU. Therefore, it is difficult to understand, why Estonia has decided to add qualitative criteria as well as additional not common quantitative criteria to the definition, when this is not a common practice among European Union member states. Although one should take into account that the economic environment and composition of enterprises by size are different in EU countries (i.e. the EU average and in Estonia, refer to Table 22 and Table 23), the author believes that the definition of micro entities included in the Draft Bill will create more confusion among financial statement preparers as well as users.

The Ministry of Finance (Ojamaa, 2015) has explained the definition used for micro entities being closely related to the concept of public interest. Namely, if a company has only one shareholder who also acts as the manager of the company and there are no other/minority shareholders, then the company has no significant parties to report to (i.e. less public interest). In addition, the Ministry has explained the concept of "company not being liable to VAT" with the fact that if company has the ability to ask the input VAT to be refunded by the tax authorities, the company automatically has public interest. Total liabilities not exceeding total equity is another measure of public interest and should protect creditors.

The author acknowledges the process of thinking behind this definition of micro companies, but is still of the opinion that it should follow a more "traditional" approach. When reviewing the current definition, creating a linkage between the micro entity definition and VAT is not justified. We could put the same emphasis on labour taxes, as employees of the micro company are "public" (society) and have "interest" in their employer (i.e. to assess if the company is solvent to pay salaries, etc.). In addition, Estonian tax authorities can always turn to the company asking for additional information on any subject matter and therefore, the linkage to (input) VAT is not justified. Secondly, the author believes that using the criteria of "company only having one shareholder" does not bear in mind the real life situation of many companies. For example if two friends or a husband and a wife decide to establish a company together both having 50% shareholding, then these kind of companies are automatically treated as small companies (not even considering the number of employees, total revenues or assets) and cannot benefit from the simplifications for micro companies. However, the question of "public interest" and the latter being hampered can be resolved with other measures. For example, the shareholders can resolve this problem of "one of them going behind the others back" by stating in the articles of association that management board members together can represent the company in legal actions (for example signing contracts etc.). This solution would however assume that both shareholders are also management board members. In addition, there are other measures in the law that can help to protect the minority shareholder, hence this does not have to be done through the Accounting Law and micro entity definition.

The most important fact is that taking into account that according to the Draft Bill (2015) the current micro entity definition only includes approximately 16 thousand companies representing 0.45% of total revenues and assets of the Estonian companies and 1.56% of total employees, the author believes that this definition should be revised to allow more micro companies to benefit from the exemptions included in the Accounting Directive 2013/34/EU and in the Draft Bill.

4.2.5.2. Complete Set of Financial Statements for Micro-, Small- and Medium-Sized Entities

One aim of the doctoral thesis was to find out the complete and cohesive set of financial statements that would satisfy the needs of different users. Based on the survey, the author has included a complete set of financial statements for micro-, small and medium-sized entities in Table 54. All entity size groups should file everything the size group is required to prepare to the Commercial Register.

Table 54. Complete set of financial statements for micro-, small and medium-sized entities

	Micro entities	**Small entities**	**Medium-sized entities**
Balance sheet	Abridged balance sheet as proposed in the Accounting Directive 2013/34/EU – refer to information included in Table 5 in respect of micro entities	Abridged balance sheet as proposed in the Accounting Directive 2013/34/EU – refer to information included in Table 5 in respect of small entities	Balance sheet as currently required under the Estonian Accounting Act
Income statement	Abridged income statement as proposed in the Accounting Directive 2013/34/EU – refer to information included in Table 6 in respect of micro entities	Income statement as proposed in the Accounting Directive 2013/34/EU – refer to information included in Table 6 in respect of small entities (not starting with gross profit (loss))	Income statement as currently required under the Estonian Accounting Act
Cash flow statement	Not required	Not required	Required
Statement of changes in equity	Not required	Not required	Required
Notes to the statements	Required*	Required*	Required*
Management report	Not required	Not required	Required

*further details included in the analysis below
Source: composed by the author based on the survey results

When it comes to micro entities, the author believes that this size-group should be allowed to prepare an abridged balance sheet and an abridged income statement (exemption) as it is outlined in the Accounting Directive 2013/34/EU. In respect of the publication of the annual report, micro entities should also publish all statements and notes they are required to prepare. Although the survey showed that there was scarce support for presenting only the abridged balance sheet among all the respondents, when looking at the answers of micro entities size group separately, then 44% considered it reasonable to publish only abridged balance sheet, 38% had the opposite opinion and 18% did not know what to think. If those currently in-between respondents (18%) would change their minds and would not support filing only the abridged balance sheet, then 56% of respondents would be opposed to that simplification. Also, taking into account the survey results in other areas, then the users of the financial statements are the most interested in income statement line items (sales revenue, different profit (loss) numbers). This shows additional support towards making micro entities liable for the publication of all reports they have to prepare.

The proposed format of financial statements for micro entities has been an issue that is also outlined in the Accounting Directive 2013/34/EU – namely, when the financial statements are that compact/abridged, it is not possible to state that they will give a true and fair overview of the entity's financial position. To overcome this limitation, the Estonian Ministry of Finance has introduced a concept called "Compliance Framework" in the Draft Bill of Accounting Act described more detail in Chapter 4.2.3. The annual report of a micro company only includes information that is required by law. Therefore, the financial statements of micro companies do not to give a true and fair view of the financial position, financial performance and cash flows of the company and are not a sufficient information source for users with financial knowledge to use as a basis of economic decision-making process.

When comparing the author's proposed format of micro entities financial statements with the Draft Bill of Accounting Act, the main, but not significant, difference lies in the income statements. As the respondents of the survey preferred drafting an abridged income statement as included in the Accounting Directive 2013/34/EU, the longer version of the income statement proposed in the Draft Bill of Accounting Act is not in line with their needs. However, when actually comparing the two versions of the statements, the difference only lies in some rows (such as variation in stocks of finished goods and in work in progress, work performed by the undertaking for its own purposes and capitalised) and most micro entities may not even be engaged in activities creating these financial statement line items.

It is difficult to compare the financial statement formats of micro entities with other European union member states, because there are only few countries who have defined micro entities in their legislation (Slovenia, Spain) and there is little to no information available about the simplifications created for these companies. Therefore, it is difficult to perform comparison with other practices as the definition of a micro entity is a new concept and therefore, the proper accounting practice for these companies can only form over time. Currently, one can only balance between what is required by the Accounting Directive 2013/34/EU and what the actual needs of the SME financial statement users/prepares are. This is at least what the author of the thesis has done.

In respect of small entities, the author believes that this size-group should be allowed to prepare the balance sheet and income statement as outlined in the Accounting Directive 2013/34/EU. These companies should not prepare an abridged version of the income statement (simplification allowed in the Accounting Directive to start the statement with gross profit (loss)), because this was not supported by the respondents and also taking into account the users great interest in income statement line items (especially sales revenue).

The author believes that the cash flow statement and statement of changes in equity should not be required from these companies although not including the statement of changes in equity in the financial statements was scarcely supported by the respondents. Not preparing and presenting the cash flow statement and statement of changes in equity is also in line with the current practices of other European Union member countries.

When comparing the author's proposed format of small companies financial statements with the Draft Bill of Accounting Act, then the author believes that small entities should not be obliged to prepare a management report, as dismissing this was quite strongly supported by the respondents of the survey. The latter is also in line with the current practices in many of the member states. In many countries, SMEs are exempted from drawing up management report, if they disclose some additional information in the notes. In addition, from the personal experience of the author the management reports of Estonian small sized companies rarely include some additional/valuable insight into the company's activities. What is required by the law (for example according to § 24 of the Accounting Act the management report has to include the most significant investments made during the financial year and planned in the immediate future, and significant projects in the field of research and development and the related expenditure in the accounting year and the following years) is often not disclosed. Also, the users of SME financial statements were more interested in other parts of the small company's annual report, which further supports not preparing the management report. To conclude, the author believes that not requiring the preparation of a management report from small companies is reasonable.

In respect of medium-sized entities, the author believes that this size-group should prepare and file financial statements in a similar way that is currently required by the Estonian Accounting Act. This opinion is based on the fact that this size group was the most opposed to all the simplifications allowed in the Accounting Directive 2013/34/EU for micro and small companies. As some of the allowed simplifications were the same for both small and medium-sized undertakings, then one could conclude that if they were opposed to changes affecting small companies, they would be also against the same changes if they affected their size group.

When comparing the author's proposed format of medium-sized entities financial statements with the Draft Bill of Accounting Act, they are quite similar, because the author believes that the effective Accounting Act satisfies the needs of users of medium-sized entity's financial statements and according to the Draft Bill of Accounting Act, no significant changes are anticipated to the accounting and reporting requirements of medium-sized and large companies compared to the current legislation. Still, in the European Union, there are only a few countries, which require a "complete" set of financial statements for medium-sized companies, including a management report, a statement of cash flows and a statement of changes in equity. Most of the EU member states have introduced some kind of exemptions to this size group. So, when Estonia decides to continue with the current format of financial statements, it would "go to the other direction" compared to current practice.

When comparing the IFRS for SMEs – that is also incorporated in the effective Estonian GAAP – with the complete set of financial statements for SMEs proposed by the author, then the differences, of course, are great in respect of micro and small-sized companies. The overview of this comparison is also included in Tables 50 and 51. The proposed cohesive financial statement format for medium-sized companies, however, is quite similar to the requirement included in the IFRS for SMEs.

When reviewing the information the users would like to see in the notes of the annual report, one can see that the needs and expectations of users are a bit different and depend on the size group that the respondent belongs to.

In general, more than 50% of the respondents would like to see information about the number of employees, information about significant loans and related terms, analysis of net sales by geographic regions and the book value of assets leased under finance lease terms in the annual report. This shows the ongoing interest in sales revenue and staff expenses (already brought out in the income statement analysis) and about borrowings – both loans and finance lease (chosen by respondents in the balance sheet analysis).

It was interesting to note that the users have little interest in social responsibility reporting, but this may be caused by the fact the respondents may not be familiar with the term (report form) and as the questionnaire was completed mainly online, it was also not possible to explain to them what it is. The little interest in the significant inputs of goodwill impairment tests, foreign currency transactions and research and development costs can be explained by the fact that Estonian SMEs do not have transactions like that – they are not engaged in foreign operations nor do they acquire other entities.

When reviewing the results by company size group, the micros consider the top 5 disclosures to be: the average number of employees, information about significant loans and related terms, the book value of assets leased under finance lease terms, the fair value of property, plant and equipment and information about business combinations. The respondents of medium-sized companies believe that information about the events after the balance sheet date is more important than the fair value of property, plant and equipment. The respondents from small companies prefer to see analysis of net sales by geographic regions and events after the balance sheet date instead of the book value of assets leased under finance lease terms information about business combinations.

It is interesting to note that the micro companies are more interested in the fair value of property, plant and equipment and information about business combinations, when the small companies are not that much interested in either of them and medium-sized companies are only interested in business combinations. On one hand, the micro entities should not be engaged in acquiring other entities, but should rather be focusing on their own business activities that are situated in one country (i.e. no cross-border activities) – that is at least what the European Commission expected when it described the main characteristics of a micro entity in its research documents. Also, in the Accounting Directive 2013/34/EU the micro entities were exempted from using the fair value in their financial statements, which is also not in line with their interest in the fair value of property, plant and equipment. One explanation can be that when property values are increasing at the time of the study, one may argue that the accounts should therefore report upon revaluations (Sian and Roberts, 2009). Nevertheless, more information is needed about this "abnormality" to make conclusions about the real interest of micro entities in respect of information to be disclosed in the notes to the financial statements.

When comparing the needs of SME financial statement users about the disclosure requirements included in the EAA and in the EASB guidelines, the current legislation requires all the companies to disclose the average number of employees, information about significant loans and related terms, analysis of net sales by geographic regions and the book value of assets leased under finance lease terms. So, in that respect the accounting legislation already satisfies the needs of SME financial statement users. When comparing the needs of users with the Draft Bill of the new Accounting Act effective from January 1, 2016, micro entities only have to disclose 3 notes (including accounting policies) and small companies approximately 9, which is not fully in line with what the respondents of the survey would like to see in the notes. For example, the Draft Bill of new Accounting Act does not require the disclosure of analysis of net sales by geographic regions and the book value of assets leased under finance lease terms. So, in respect of the notes to financial statements, the views of the survey respondents are mixed – on the one hand, they would like to see more information as it is currently required by the Draft Bill of the new Accounting Act, on the other hand they agree with the proposals made in the Accounting Directive 2013/34/EU and support preparing smaller number of notes and therefore, presenting less information in the financial statements. To conclude, the information to be disclosed in the notes can be summarised with a comment made by one of the respondents – the additional information that users would like see in the notes to the financial statements of their competitors is not the information that the company itself would like to disclose to its competitors. So they would like to see more information in the notes as users, but when put in the shoes of the preparers of financial statements, they are willing to disclose only what is required from them by the law.

The survey also included questions about the main users of the company's financial statements from the preparers' point of view (i.e. who are the actual users to whom the financial statements are provided and who are the perceived users who are considered to be using the financial statements of the company, but to whom the company does not itself provide financial statements). For the latter question, the answer was competitors, credit rating agencies, state, trade creditors and suppliers and customers. When preparers themselves use the financial statements of other SMEs they do it mainly as competitors, customers and suppliers.

The results show that users of SME financial statements use information about sales revenue, net profit (loss), gross profit (loss), operating profit (loss), and staff expenses most often – all of these answers were mentioned by at least 50% of the respondents. This shows that Estonian SME financial statement users attach great importance to the income statement, which indicates that the users support the entity view of the different equity theories. Namely, the entity view considers the income statement as the primary statement because it enables assessment of performance over the period, and the calculation of dividends for distribution and earnings to be retained in the company (Van Mourik 2014, 33).

The analysis has shown that when users look at the SME financial statements as competitors, they attach the most importance to sales revenue, staff expenses, net profit (loss), gross profit (loss) and operating profit (loss). As clients, the interest is in net profit (loss), sales revenue, operating profit (loss), gross profit (loss) and trade and other payables. As trade creditors the most attention is paid to sales revenue, net profit (loss), gross profit (loss), operating profit (loss) and total equity, and total current assets are not far behind.

The information needs of competitors agree with the information needs of all respondents (i.e. all different user groups). As clients, the financial statement users pay attention to trade and other payables as well, whilst they do not consider staff expenses that important. As trade creditors, users focus more on equity instead of staff expenses. Paying more attention to trade and other payables and equity may be another indication in support of the entity view. According to Van Mourik (2014, 33) the balance sheet was secondary as it was not meant to indicate the firm's value, but rather to show the company's assets and all the stakeholders' interests (including creditors/lenders as well as owners) in order to give an indication of solvency (Van Mourik 2014, 33). The author believes it might be support towards the entity theory, but it is difficult to understand just based on the questionnaire and without any additional insight into the purposes for which these balance sheet items (borrowings and total owner's equity) are used.

It is also quite logical that from the viewpoint of competitors the financial statement users place importance on different profit levels as they may be interested to know, how the competitor has priced their products (which is reflected by gross margin), what it spends on operating expenses (which is reflected by operating margin) and on what it earns profit. It is the same with staff expenses – it is a well-known, although not publicly discussed fact, that Estonian enterprises use staff expenses to determine how much money the competitor pays to its employees to adjust the salaries within their own companies to a similar level. Trade creditors' interest in equity is understandable as well – they view it to evaluate the solvency of the company and therefore, its ability to pay for the goods/services delivered to them. Trade creditors were also more interested in total current assets than other parties, as they would like to know whether the company has sufficient liquid assets to pay for its debt. However, it is more difficult to understand the concern about the trade and other payables from the client's perspective. This would require some in-depth interviews with these parties to enlighten this interest.

When reviewing other components of the annual report in addition to the main statements, notes and the management report, one can see from the survey results that the users of SME financial statements do not attach great importance to an independent auditor's report. The question arises, why that is so and if the importance of independent auditor's report might be is underestimated by the financial statement users in Estonia? This maybe illustrated by the fact that when a recent corruption scandal related to the management of Port of Tallinn became public, the press started to pay more attention to the independent auditor's report of the respective company as well. The opinion of the company was qualified and stated the auditor was not able to obtain sufficient audit evidence about the value of non-current assets (i.e. whether they are impaired or not). The carrying amount of these assets was 50.9 million euros and the auditor's opinion had been qualified for the same reason already in previous years (Port of Tallinn 2014). If the company had recorded an impairment in the same amount as the carrying value of these assets, the company would have been loss-making instead of having a profit in the amount of 38.3 million euros (Port of Tallinn 2014) and would not have been able to distribute dividends. Nobody brought this out – at least not in public – before the corruption scandal broke down. Even the Estonian government, who is the owner of Port of Tallinn, did not pay attention to this, which is illustrated by the fact that this qualification had been in the independent auditor's report since 2007 and hence, being overlooked since then. Therefore, the author of the thesis believes that the Estonian Government should make investments to educate the companies (preparers) and their financial statement users about the importance of an independent auditor's report. Although there is no information publicly available about how many companies "end up" with qualification, disclaimer, adverse opinion etc. in their financial statements, then not paying attention to this or misinterpreting the information included in the independent auditor's report may seriously affect the financial statement users and their decisions.

It is actually the same with accounting policies, which are and continue to be an integral part of the financial statements. According to the survey results, this "note" is one of the less used parts of the financial statements, although it is mandatory to be included in the annual report based on the effective Accounting Act as well as based on the Draft Bill. The author believes that the users do not understand how choosing one or the other accounting principle can significantly influence the balance sheet as well as the income statement. Let us look at the example of investment property. Under Estonian GAAP, companies can choose whether to record investment property in fair value, when this value can be found with reasonable effort and expenses, or record it at cost. Finding a new fair value each year may lead to an additional profit each year using the assumption that the property prizes in general are increasing and there are no significant improvements needed in respect of that investment property. On the other hand, using the cost method would mean additional expenses to the profit or loss statement and therefore, less profit or bigger loss to the company in general. When the user reviews the company's performance as a competitor and compares the profit levels of both companies, not understanding the accounting policies used that ultimately impact the profit earned, may lead to wrong conclusions and wrong investment decisions.

Attaching too little importance to an independent auditor's report as well as accounting policies may indicate that the Estonian financial statement user is not that sophisticated when it comes to interpreting the financial statements and the information included therein. Therefore, importance should be placed on the educating the financial statement users. This can be in the form of including more sophisticated financial statement analysis to the curriculum of bachelor students studying economics as well as providing additional trainings and guiding materials to existing business owners and their financial staff.

4.2.5.3. Accounting Principles Applied by Micro, Small and Medium-Sized Entities

The current accounting legislation in respect of accounting policies governing the preparation of financial statements seems to satisfy the financial statement preparers. It was found out that 94% of the respondents use Estonian GAAP in preparation of the financial statements and 6% use the IFRSs (as adopted by the EU). This is in line with the fact pointed out by Ago Vilu, chairman of the EASB, in 2004, that approximately 95% of Estonian companies use Estonian GAAP and 5% the IFRSs in preparing financial statements.

Although many changes were introduced to the EASB guidelines effective from January 1, 2013, these had no impact for 68% of the respondents. For others, the most significant impact came from accounting for investment property, assets held for sale and government grants. Taking into account that principles for accounting for investment property was later amended (allowing again the cost method) the changed standards have an even smaller impact on preparers. Still, based on the answers received, the EASB could reconsider the accounting government grants (i.e. allowing gross method again). For accounting for assets as held for sale, the author of the thesis believes that this should remain as it is. This is because classifying assets as held for sale requires assessment whether the preconditions are met and this is something, the companies seem not to think about, but just record the sale of the asset when the transaction is done. In addition, recording the assets as held for sale can only have an impact on net working capital at some point of time and income for the period, if the sale occurs in the next financial year. Therefore, the author believes that the simplification not to record assets held for sale should be kept.

When introducing new standards, the EASB could consider organising courses for financial statement preparers as this seems to be one of the most common ways how the respondents become familiar with the upcoming changes. In conclusion, the current EASB guidelines that follow the principles of the IFRS for SMEs seem to satisfy the preparers of financial statements and based on this information, no significant changes should be introduced to those accounting standards in the future.

However, when taking into account from whose perspective the financial statements are compiled, the survey conducted among SME financial statements users showed great support towards the entity perspective. When analysing the current Estonian accounting legislation in Chapter 1.6, the author concluded that as the Estonian accounting legislation is heavily influenced by the international financial reporting standards developed by the IASB, it is difficult to point out which equity theory they follow as different elements of financial statements give implications to different equity theories. Maybe in the future, when implementing or developing the new accounting standards in Estonia, it would reasonable to think about equity theories (especially entity theory) before making decisions about one or the other accounting principle.

4.2.5.4. Involving Micro, Small and Medium-Sized Entities in the Development of Accounting Legislation

One of the aims of the doctoral thesis was to investigate, whether the Estonian SMEs have been engaged in the debate of developing new accounting standards and if not, what the main reasons hindering their participation are.

The results of the survey show that nobody from the 93 respondents had ever participated in the standard setting process or made proposals to the EASB in respect of new guidelines. The reasons, why respondents have not participated in the standard setting process, included: they are not aware that they can actively participate and influence the development process (45 respondents), lack of resources (money, time, skills and knowledge) (39 respondents) and belief that the participation of SMEs is not needed, because the decisions are based on what the government wants (37 respondents). The author believes that this information should be alarming to the Estonian Government, especially the Ministry of Finance.

The main issue seems to be that the companies do not know that they can participate in the standard setting process. This can be easily overcome with proper publicity through the appropriate channels, when new accounting standards or laws are being developed. For example, this can happen through the “umbrella organisations” of different companies in Estonia or approaching the companies directly by using the contact information included in the Commercial Register. The information provided through these channels may be a simple announcement of changing laws and including a link to respective documents.

The second issue – companies not having sufficient resources – is a more difficult one to deal with. It is complicated to provide companies with additional time, but the government can provide help and solution to companies not having sufficient money and knowledge. Namely, by reducing the administrative burden in the form of different reporting, there is an opportunity to create additional time to accountants so that they can participate in trainings, familiarise themselves with different accounting legislations and proposed change. Of course the question remains if the additional free time will be actually spent for that purpose, but the government can give a helping hand by introducing free “Information days” to management and accountants of companies and providing them additional information through the channels described in the previous section. The change in the mind-set of the companies towards understanding the importance of participation in the standard-setting process will not happen overnight, but as a democratic country, we should aim towards including proper parties into decision-making directly affecting them.

The author already covered the lack of skills and knowledge in Chapter 4.2.3., but in this section the author would like to further analyse the reasons for this and make recommendations for the future. The author agrees that the Estonian SME financial statement users may not be as sophisticated as their peer group in the USA or UK and believes that there are many reasons for that – short history of market economy, developing accounting education, little to no accounting research at PhD level, and only a few accounting journals. However, steps should be taken to overcome the gap of SMEs not having sufficient skills and knowledge to participate in the standard setting process. There are different measures one could take starting again with free “Informational days” or trainings to the management and accountants of companies were relevant subjects will be covered. These can be organised by “umbrella organisations” or by the Ministry of Finance itself or can be ordered from private sector or universities.

The third issue – belief that the participation of SMEs is not needed, because the decisions are based on what the government wants – is a direct critique in the address of the Estonian Government and shows that the Ministry of Finance has not included proper parties in the development of the accounting standards. To illustrate this opinion, the author has analysed the recent standard setting process in Estonia more thoroughly in the following paragraphs.

When looking at the recent history in the standard setting process in Estonia, the prior decisions were based on the “best accounting practice of the world” – i.e. Estonia has copied the standards and regulations of the IASB or after joining the EU, endorsed the respective directives. Until recently, there has been no research conducted among practitioners or companies that would analyse the views and opinions of those interested parties on how Estonia should develop its accounting framework and standards. The first time, when a more "thorough" analysis was carried out by Estonian Ministry of Finance was in spring 2014, when survey was conducted to investigate, among other things, how Estonia should implement the new Accounting Directive. Although this survey was first attempt to involve interested parties into a decision making process in respect of the important accounting and financial reporting issues, this survey was far from an "ideal" one and in the opinion of the author, needs great improvement in the future so that it could be used in the development of the accounting legislation. To prove the point, the author has included below the main limitations of the survey and made recommendations for improvement to achieve the ultimate goal of involving SMEs in the development of the new accounting standards.

The survey conducted by the Estonian Ministry of Finance had many limitations that make the results and decisions based on that survey very subjective. From reading the survey report, one can bring out the following limitations – the survey used convenience sampling to receive answers. The survey was sent to different organisations by e-mail providing a link to the questionnaire that was conducted in an internet-based tool (Survey Monkey). The survey link was provided to at least 24 organisations (the full list is not included in the final survey report). In analysing the answers, the respondents have been divided into four groups: private persons (experts) (66 respondents), "umbrella organisations" (6), companies (57) and the public sector (19). From the 148 people who started answering to the questionnaire only 95 completed the whole survey, but the analysis included all the responses – even by those people, who did not finish.

The "umbrella organisations" included at least the EASB, Estonian Board of Auditors (EBA), Estonian Association of Accountants (EAoA) and Estonian Chamber of Commerce and Industry. Why "at least" is that for some questions it is shown in the analysis that there were 6 "umbrella organisations" answering to that question, but there is no information, who were the rest of them.

The survey report also includes a further grouping of private persons (or experts) – they were mostly divided between independent auditors (28 people) and accountants (19 people). With that one can say that the proportion of independent auditors in the whole survey is quite high, constituting approximately 30% of people finishing the survey. This may indicate that the survey may be biased towards this interest group. The author would also like to challenge the fact that the opinions of "umbrella organisations" were equalised with the opinions of other respondents. For example, both the opinions of the EASB and an assistant/data administrator in private persons group were counted as one vote. The author of the thesis believes that this is not reasonable and more emphasis should be placed on the opinions of "umbrella organisations". One of the reason for that is that, for example, in the case of Estonian Chamber of Commerce and Industry, it seemed from the survey report that the respective organisation had conducted a separate research among its members using the same questionnaire and after summarising the results, presented this view to

Ministry of Finance. If this is the case and all the members of Estonian Chamber of Commerce and Industry would have responded to the questionnaire of Ministry of Finance separately, this may have changed the results and the decisions based on this survey.

In addition, nothing is said in the final report, who were the companies participating in the survey, i.e. if they were all members of one specific “umbrella organisation” for example Estonian Business Association of Large Enterprises or if the Ministry of Finance also provided the survey link to some predetermined companies whose names were not disclosed in the report? This information is important for the reader of the report as it may reveal whether the survey is as objective as stated and actually includes proper parties. For example, it is difficult to ask questions about nano/micro entities from large companies on whom the proposed changes in EAA have no effect.

Further, the survey does not provide information about who are included in the public sector. In most cases, the respondents from public sector “agree” or “mostly agree” with the suggestions of the Ministry of Finance – at least in that section of the survey, which discussed the proposals in respect of preparing the annual report (section 4). Again, one can argue that as the proportion of public sector in the whole survey is quite high, constituting approximately 20% of people finishing the survey, the survey results may be biased and not reflect the opinions of actual SME financial statements users and preparers.

To conclude, for the reasons mentioned above, one can argue that by conducting the survey, the Estonian Ministry of Finance was not successful in targeting the correct interest groups to answer some parts of the survey. In the future, more importance should be placed in carrying out the survey in a more transparent way and ensuring that one respondent group is not dominant. The author believes that one way to improve the level of research is to give out more grants to PhD students or order the studies from public/private sector, who have more experience in conducting surveys like that. A more valuable insight could be also found from focus groups and interviews and not use the internet-based questionnaire as the only measure for gathering information. Also, a lot more research is needed not only on pre-implementation of some new accounting standards (in this case the Accounting Directive), but also analysing the effects of changes post-implementation. For example, after the new Accounting Act has been enforced, thorough research should be conducted in two year time to analyse the effect of changes on the transparency and reliability of SME financial statements – things that the Government believes decrease the most after implementing the new Accounting Directive. One is certain – Estonia should move towards involving SMEs in the standard setting process as they constitute a way too important part of the Estonian economy to not take their opinions into account.

4.2.5.5. Decreasing the Administrative Burden of Micro, Small and Medium-Sized Entities Furthermore

The main information source used by users of SME financial statements is the annual report of the company and it is retrieved from Commercial Register. The median cost per company for gathering information about other SMEs is up to 50 euros per year. According to the statistical profile of Estonian SMEs in 2013, there were 112,578 economically active SMEs in Estonia (Statistics Estonia, 2014b). Therefore, the administrative burden these companies incur is 5.6 million euros assuming that on average, the costs for gathering information about other SMEs is 50 euros.

In light of this information, the government should also consider decreasing the fees payable or even making requests to review the annual reports of other entities in the Commercial Register free of charge. The author acknowledges that the Commercial Register incurs costs for keeping up their IT-systems, gathering different information from entities, etc. The author investigated also from the Commercial Register, how many requests for review of annual reports are made per year or per company, but unfortunately the office does not provide this kind of information to third parties. Therefore, it is not possible to calculate the revenues the state would lose if they made the reviewing of annual reports in the Commercial Register free of charge. Still, without being able to perform more thorough cost-benefit analysis, the main argument for making it possible to review annual reports free of charge is that as a primary source of information for SME financial statement users, it would help the users to get valuable information as competitors, customers and suppliers about other SMEs and would help them to better assess the credit risks associated with the other company or just compare the financial results of their own company with the competitor operating in the same industry. Allowing the free of charge access to annual reports of SMEs would help users make more informed financial decisions.

When analysing the expenses companies incur when preparing the financial statements, the main cost components are: the salary of accountant(s) and fees paid to the company's auditors. 42% of the respondents (mainly from small and medium-sized companies) stated that it cost more than 1,000 euros a year for the company to prepare the annual report. Based on the author's calculations, the potential administrative burden Estonian companies incur, would be at least 6.9 million euros. From the preparer's (company's) point of view, these costs are probably high, but one should also take into account the user's perspective. The current study has shown that when users review the financial statements of other SMEs, the independent auditor's report is often used by 18 users, sometimes used by 36 users and never used by 18 users (11 of them are micro entities, who do not have audit/review obligation). Also, larger companies seem to use an independent auditor's report more than smaller entities (i.e. the medium-sized companies use the independent auditor's report more than small and micro entities). Based on the facts that a) one of the main costs companies incur when compiling financial statements is the audit fee, and b) an independent auditor's report is more valued by larger companies, the Estonian government should re-consider the thresholds set for review/audit obligation with a view to increase them.

This is actually something the Estonian government is currently in the progress of doing. In the proposal, the quantitative criteria set for companies to have audit obligation (total revenues, total assets, average number of employees) has been "doubled" compared to the current effective legislation (Draft Bill of Estonian Accounting Act 2015). This change has been justified by conducting an analysis how much of the total revenues and total assets of the companies would still be covered by the audit or review, if the new changes were implemented. The general aim of the ministry's proposal is to reduce the administrative burden of the companies. The author of the thesis believes that this is a good basis to start from, but maybe further analysis would be required to understand the impact of changing the law on the auditing practice. According to the information of the Ministry of Finance (2014), the change would mean that approximately 2,700 companies would no longer need an audit or a review. For the auditing practice this would mean that some of the certified independent auditors in Estonia providing services to smaller entities that are out-of-scope of the new law may find themselves out of work. This is something that the government needs to work on to find possible solutions – redirect them to other types of assurance services, other fields of activities (i.e. accounting), etc.

4.3. Concluding Remarks on Financial Reporting of Micro, Small and Medium-Sized Entities in Estonia

After analysing the survey results conducted by the author with the Draft Bill of Accounting Act and requirements included in the Accounting Directive 2013/34/EU, one can say that Estonia is currently moving in the right direction with its new accounting legislation. There are some differences that the respondents of the author's survey would like to see in the new Accounting Act compared to what is included therein. The main point is that the respondents of the survey would prefer more simplified financial statements for micro and small companies than the one allowed by the Draft Bill of Accounting Act. What Estonia has done in line with the expectations of the survey respondents, is dismissing the requirement to prepare a management report for micro entities and not endorsing the abridged income statement format starting with gross profit (loss), which was one of the exemptions allowed in the Accounting Directive 2013/34/EU.

However, the current decisions made by the Estonian Government attach too little importance to surveys among interested parties and may rely too much on the opinion of certain organisations/people. On one hand, the author understands that Estonia is able make decisions within the boundaries set by the European Union, nevertheless, the Accounting Directive includes options that should be carefully considered before implemented. Therefore, the author recommends that the Ministry of Finance would carry out more thorough studies about different accounting and financial reporting issues in the future. One of the researches should analyse the financial statements of micro and small companies after the implementation of the new EAA to find out whether both the users and the preparers as satisfied with the changed regulation and to investigate, whether the change has impacted the transparency and reliability of the financial statements as feared by many interested parties, including the Ministry of Finance itself. If research showed some discrepancies in what has been endorsed compared to what the users and preparers would like to see, the government could consider implementing some of the alternatives allowed in the Accounting Directive 2013/34/EU.

The author thinks that more thorough research should also be conducted using the financial statements of medium-sized and large companies – although the changes in the EAA effective from January 1, 2016 have no impact on the financial statements of these companies, the disclosures included in their annual report need further investigation to verify, whether they disclose everything as required by the law or not. If non-compliances are found (as has been suggested by some of the research conducted at the bachelor level), the government should consider changing the law or introducing new measures to verify, that the information included in the reports is correct and satisfies the needs of users.

Another remark the author would like to emphasize is that the government should start looking at the reporting requirements of SMEs as one opportunity to increase foreign investments in Estonia. Currently, the Estonian success story as a great place to invest has relied on factors such as stable government, liberal economic policy, moderate costs (including taxes) and the ease of doing business. However, the author believes that after setting up an entity in Estonia, this "ease of doing business" should continue in the form of reasonable accounting and financial reporting requirements. This does not mean that Estonia has to become am "accounting haven" (similar to "tax havens"), but we should not require more from our companies than our competitors (nearby countries) do. Although there is no comprehensive overview available yet, how other countries plan to implement the requirements for micro entities as described in the Accounting Directive 2013/34/EU, the author firmly believes that no other country will introduce such a complex and non-standard definition to micro entities. It is clear that with that definition, the Ministry of Finance tried to keep the newly introduced concept of "nano entity" and shift as many entities as possible to the small company category, where reporting requirements remain more similar to what is currently expected from all companies.

The author acknowledges the government's need to gather information about the smallest companies, but doubts whether the cost-benefit analysis really supports the current micro entity definition that is included in the Draft Bill of Accounting Act. For example, if Estonia used the micro entity definition included in the Accounting Directive 2013/34/EU this would mean that we would get much less information about 96% of Estonian companies (Estonian Ministry of Finance 2014a). This number seems high but based on the 2012 data, these companies would make up 21% of total revenues earned, 33% of total assets owned and 37% of employees employed by all the Estonian companies (Estonian Ministry of Finance 2014a). On the contrary, the current micro entity definition included in the Draft Bill (2015) only includes approximately 14% of Estonian companies representing 0.45% of total revenues and assets and 1.56% of total employees. Taking into account the Pareto principle that roughly 80% of the effects come from 20% of the causes, maybe Estonia should apply this concept to the micro entity definition as well – 80% companies who give 20% of the output (revenues, total assets, employees) should be included in the micro entity category. This would mean that our definition of micro entities would become more similar to the definition included in the Accounting Directive 2013/34/EU. To conclude, after conducting the survey, gaining more understanding about the current financial reporting situation among SMEs (especially micros) and reviewing the available options in other countries, the author firmly believes that the micro entity definition should be reconsidered.

CONCLUSION

Globalization and transnational business expansion has resulted in an increased need for uniform rules so that the financial statements in different countries are prepared on a similar basis, and there would be no possibilities for interpretation. However, one should bear in mind that these uniform rules should not place too much administrative burden on the smallest of companies and therefore, the need for differential reporting exists.

To address the different issues financial reporting is facing and that have been brought out by many researches the thesis used a "top-down" approach to the question what the basis for cohesiveness of financial statements should be. Namely, it started with the general analysis of the current "accounting theory" to understand the principles and rules that currently govern the compiling of financial statements. Then it moved on to identifying and assessing the institutional factors influencing not only the theory of how financial statements should be prepared, but also the actual practice. This was done using the institutional theory and identifying the coercive, normative and mimetic pressures affecting the preparation of financial statements of (Estonian) companies. Finally, the theory was combined with practice using empirical research among Estonian companies. A survey was carried out to understand, what Estonian financial statement users and preparers would like to see in the SME financial statements.

From the theoretical perspective, it was analysed whether equity theories may provide a frame of reference for the objectives of the financial reporting (i.e. could be interpreted as "accounting theory"), and therefore, to the presentation and measurement of information reported in the (SME) financial statements. As shown through the analysis of the conceptual frameworks of the IASB and the FASB, a comprehensive theory of financial accounting and reporting that would place into one single framework the different views of different companies and disclosure formats seems to be impossible to achieve. The author's **theoretical contribution to the analysis of equity theories is:**

- Summarizing the first attempts to define the theoretical basis of accounting on a timescale. The author included in Figure 2 the equity theory which best describes the respective period and the users from whose point of view the financial statements should be presented.
- Reviewing the conceptual frameworks of the IASB and the FASB from exposure draft to developed standard to identify, whether these documents follow equity theories. The emphasis was on the objectives of financial reporting and who are considered to be the users of the financial stataments. The results of the author's analysis are summarized in Figure 3.
- Analysing Estonian accounting framework from the viewpoint of equity theories and mapping the results.

According to Van Mourik (2010b), an accounting theory should explain what the social, economic, legal and behavioural assumptions are behind the different income determination models, measurement and valuation paradigms, as well as the financial statement formats and other means of disclosure. However, it would never be "one size fits all theory" (Van Mourik, 2010b). When taking into account the short accounting history of Estonia and limited research about it, it is clear that there are currently not enough resources available in Estonia to develop a comprehensive theory in accounting that would be the basis for accounting legislation further on.

In addition, the thesis aimed to find out, what are the institutional pressures affecting the development of the financial accounting framework in Estonia. This analysis was conducted using the instutional theory developed by American sociologists Powell and DiMaggio (1983). Although using institutional theory to interpret factors affecting the development of the financial reporting framework is not new, its application is underexplored in the context of post-Soviet countries such as Estonia. The author's **theoretical contribution to the analysis of institutional pressures** was:

- Analysing the coercive institutional pressure based on the Estonian accounting legislation from 1990 to 2012 and mapping the results. The author identified that in addition to the IASB, the EU's Accounting Directives influence Estonian accounting standards significantly. This was not pointed out by previous researchers.
- Using the transparency reports of the "Big4" companies to identify, whether they act as normative institutional pressures in Estonia. Previous researches used other measures to identify the dependency.
- Reviewing the structures and working practices of the EASB to identify potential mimetic institutional pressures.

The results of the authors' research showed that in the context of coercive institutional pressure the development of the accounting legislation in Estonia has been mostly influenced by the IFRSs. These standards have been incorporated in the legislation of the EU, although some differences between the IFRSs issued by the IASB and the IFRSs adopted by the EU exist. As Estonia is a member country of the EU, the effect of the EU legislation to the Estonian standard setting process and the Estonian Accounting Act seems to be quite clear.

The author agrees with Al-Omari (2010) that in respect of normative institutional pressure the "Big 4" firms play a profound role in the globalization of accounting and represent the normative pressures that affect organizations and the choices they make in accordance to their reporting and practices implemented. Based on transparency reports, Estonian "Big 4" firms audit most of the public interest entities and can therefore influence the preparation and presentation of their financial statements. So it could be supposed that normative institutional pressures, affecting the development of the Estonian financial accounting and reporting system, are the "Big 4" audit firms. Further research in this area is needed to confirm what the normative institutional pressures (if any) are to micro companies, which are not required to be audited (i.e. if using the micro entity definition as described in Accounting Directive 2013/34/EU they do not meet the revenue, total assets thresholds set in Auditor's Activities Act).

Mimetic institutional pressures were paid less attention to in this thesis. However, in the context of mimetic institutional pressure, the trading partners of the Estonian companies, whose requirements have to be met in order to increase the export, can be viewed. Also, mimetic institutional pressure does not appear in the context of business only, where entities copy the practices of successful multinational corporations. This copying of the structures and practices may also happen, when the EASB follows the same working principles and processes as the IASB.

The theoretical analysis showed that when developing new accounting law, the best option for Estonia would be to analyse the local users and uses of financial statement taking into account the local context, for example the large proportion of micro- and small entities. Users' preferences, for example, about the balance sheet or income statement may help to determine from which viewpoint of equity theory they would like the standards to be developed. Still, we have to bear in mind that when we try to create rules or standards appropriate in the Estonian context, we need to juggle between the loopholes available in the European Accounting Directive as the EU is an important institutional pressure affecting Estonia's national legislation.

The aim of this doctoral thesis was at first to formulate an understanding how current and future accounting standards that govern the preparation of SMEs' financial statements expect to meet the needs of users. Secondly, how should a complete set of financial statements look like that satisfies the needs of Estonian stakeholders.

To answer these questions the author conducted a survey among Estonian companies. The total number of answers received in the empirical research was 93, which was divided between micro, small and medium sized companies as follows: 39 answers from micro entity representatives, 40 from small companies and 14 from medium-sized companies. The author recognises that this survey, like most of the studies concerning users, has some limitations, but this does not diminish the value of the survey in general to provide insight into the SME financial reporting.

In general, the current accounting legislation in respect of accounting policies governing the preparation of financial statements seems to satisfy the financial statement preparers. Although many changes were introduced to the EASB guidelines effective from January 1, 2013, these had no impact for 68% of the respondents. For others, the most significant impact came from accounting for investment property, assets held for sale and government grants. When introducing new standards, the EASB could consider organising courses for financial statement preparers as this seems to be one of the most common ways how the respondents become familiar with the upcoming changes. In conclusion, the current ASBGs that follow the principles of IFRS for SMEs seem to satisfy the preparers of financial statements and based on this information, no significant changes should be introduced to those accounting standards in the future.

The survey results showed that the Estonian SME financial statement users, to whom the company itself provides the financial statements, are considered to be the owners, the company's management, the state (including the Commercial Register, Tax authorities) and banks and other creditors (being mentioned by at least by 50% of the respondents). These results partially coincide with prior research (refer to Table 3 in Chapter 3.4.1), but also show that in Estonia, the owners and the state are considered the main recipients of a company's financial statements. The Estonian SME financial statement users, to whom the company does not provide the financial statements, but who are perceived to use them, are considered to be competitors (the only answer being mentioned by at least by 50% of the respondents). It is interesting to note, that prior research (refer to Table 3 in Chapter 3.4.1) has put more emphasis on trade creditors and customers as the users of SME financial statements. This result coincides with another question, which asked the respondents if they as users reviewed the financial statements of other SMEs, and if they did, which user group they belonged to? The most popular answer was, of course, competitors. This is why they believe that their competitors review their financial statements as well.

The survey also aimed to find out what information SMEs utilised in analysing the financial statements of other SMEs. The most important information source is the Commercial Register, which includes the annual reports of all companies, but this source is also combined with other sources (i.e. own research on the Internet, using Krediidiinfo) to gather information about SMEs. On average, it costs companies 50 euros per year to search information about other SMEs (median value) and the search is conducted once in a quarter (mode value).

When users review the financial statements of other SMEs, they lay the greatest emphasis on financial statement line items such as sales revenue, net profit (loss), gross profit (loss), operating profit (loss), and staff expenses – all of these answers were mentioned by at least 50% of the respondents. This shows that Estonian SMEs' financial statement users attach great importance to the income statement, which indicates that the users support the entity view of the different equity theories. Namely, the entity view considers the income statement as the primary statement because it enables assessment of performance over the period, and the calculation of dividends for distribution and earnings to be retained in the company (Van Mourik 2014, 33). Entity theory assumes that an additional function is to reconcile the corporation's financial stakeholders' conflicting interests by correctly determining income for distribution (Van Mourik 2014, 34).

When reviewing the additional information contained in the financial statements, respondents would like to see in the annual report (answer given by at least by 50% of the 93 respondents): the number of employees, information about significant loans and related terms, analysis of net sales by geographic regions and the book value of assets leased under finance lease terms. It was interesting to note that the users have little interest in social responsibility reporting. The little interest in the significant inputs of goodwill impairment tests, foreign currency transactions and research and development costs can be explained by the fact that Estonian SMEs do not have transactions like that – they do not operate in foreign countries or acquire other entities.

The survey also aimed to answer to the following hypothesis: the financial statement line items that users of micro companies utilize in analysing the performance of other SMEs are different from those of small and medium-sized companies (hypothesis 1). The results showed that small and medium-sized companies as financial statement users place more emphasis on some of the income statement items than micro entities (namely EBITDA, net profit (loss), income statement related notes). The author believes that this may indicate support towards mandating small and medium-sized companies to draw up longer income statement and allow micros to use the abridged version as described in the Accounting Directive 2013/34/EU and not to draw up notes (at least to the income statement).

The survey also aimed to analyse, if financial statement line items that competitors utilize in analysing the performance of other SMEs are different from those of other user groups (hypothesis 2). The results show that competitors as SME financial statement users lay less emphasis on some of the financial statement line items than other user groups (for example some profit levels such as EBITDA and net profit (loss)). However, the needs in general are not statistically different. As already outlined before, all user groups use sales revenue, gross profit (loss) and operating profit (loss). The latter again supports the fact that when implementing the new Accounting Directive 2013/34/EU, Estonia should not adopt an abridged version of the income statement starting with gross profit (loss) and all user groups are the most interested in the sales figure.

It was also confirmed that micro companies perceive the availability, reliability, usefulness and comparability of financial statements differently from small and medium-sized companies (hypothesis 3). Namely, micro companies believe that the current situation regarding SME financial statements in Estonia is “worse” than small and medium-sized companies. This is an interesting phenomenon that can be explained by many factors. Availability can be explained by the fact that many companies do not present their annual reports to the Commercial Register timely. The question of reliability and usefulness can be explained by many relevant examples – one being that micro entities are not subject to audit or review. So, although according to the current accounting law all companies have to submit same information, in real life there are differences between the quality of micro entities’ financial statements and those of small and medium-sized companies. However, should one conclude from this that we should not adopt simplified rules for micro entities included in the Accounting Directive 2013/34/EU as this would hamper the reliability and comparability among size groups even more? The author believes that this is not the case – the general satisfaction with the current situation was 3 or higher (in 5-point Likert scale), which gives grounds to believe that the current system is reasonable.

Also, the micro companies themselves supported many simplifications allowed in Accounting Directive 2013/34/EU.

The author's **practical contribution to the analysis of users and uses of financial statements is:**

- Identifying the users of SME financial statements in Estonia;
- Identifying, what are the main sources of information SMEs use when analysing the financial statements of the other Estonian SMEs;
- Identifying the cost the SMEs occur, when reviewing the financial information of other SMEs, and the frequency of reviewing this kind of information;
- Identifying, whether users' needs (by size-group or by user group) are different or not;
- Identifying, whether accounting policies included in the ASBGs satisfy users.

The ultimate aim of the doctoral thesis was to find out what is the cohesive set of financial statements that would satisfy the needs of different users. **The author's theoretical and practical contribution is**:

- Performing an analysis of legislation effective in the EU member states affecting SMEs and mapping the results;
- Conducting a survey among Estonian SME financil statement users and preparers. A similar survey has never been carried out in Estonia;
- Benchmarking the results results against current effective Accounting Act of Estonia, European Union new Accounting Directive 2013/34/EU and the Draft Bill of the new Accounting Act (not approved and adopted by the Parliament in October 2015);
- Proposing a complete set of financial statements suitable for SMEs.

The results (also included in Table 54) showed that for micro and small-sized companies, the balance sheet should be in the abridged version as proposed in the Accounting Directive 2013/34/EU (refer to information included in Table 5). Also, the income statement should follow the same format as included in Accounting Directive 2013/34/EU (refer to information included in Table 6), except for small companies, it should not start with gross profit (loss). Micro and small companies should not be obliged to prepare and present cash flow statement, statement of changes in equity and management report. However, they should prepare limited number of notes as also described in Accounting Directive 2013/34/EU, and file everything they have to prepare to Commercial Register. Medium-sized companies should prepare annual report as it is currently required under Estonian Accounting Act (effective until December 31, 2015). Differences exist between the financial statements proposed by the author, requirements included in the Accounting Directive 2013/34/EU, in the Estonian Accounting Act (effective until December 31, 2015) and Draft Bill of the new Accounting Act (not approved and adopted by the Parliament in October 2015).

The author would also like to make the following **recommendations** based on the survey results. Namely, the author firmly believes that the definition of micro entities should be revised allowing more Estonian companies to benefit from drafting abridged financial statements. In the author's opinion, the definition currently included in the Draft Bill of Accounting Act that will become effective starting from January 1, 2016 is too complicated, i.e. it does not take into account the best practices currently adopted in the European Union countries neither does it follow the principles of Accounting Directive 2013/34/EU. Taking into account the Pareto principle that roughly 80% of the effects come from 20% of the causes, then maybe Estonia should apply this concept to the micro entity definition as well – 80% companies who give 20% of the output (revenues, total assets, employees) should be included in the micro entity category.

The author also identified that Estonian SMEs face barriers in realizing the benefits of accounting standards. The results of the survey showed that nobody from the 93 respondents had ever participated in the standard setting process or made proposals to the EASB in respect of new guidelines. The reasons, why respondents have not participated in the standard setting process, included: they are not aware that they can actively participate and influence the development process (45 respondents), lack of resources (money, time, skills and knowledge) (39 respondents) and belief that the participation of SMEs is not needed because the decisions are based on what the government wants (37 respondents). The author also believes that when preparing the new Accounting Act, the Estonian Ministry of Finance was not successful in targeting the appropriate interest groups to answer to some parts of the survey. The author **recommends** that in the future:

- More importance should be attached to carrying out similar surveys in a more transparent way and ensuring that one respondent group is not dominant;
- To improve the level of research more grants to PhD students should be granted or the studies should be ordered from the public/private sector who have more experience in conducting similar surveys;
- More valuable insight could be also found from focus groups and interviews and not using the internet-based questionnaire as the only measure for gathering information.

Also, a lot more research is needed not only on pre-implementation of some new accounting standards (in this case the Accounting Directive), but also analysing the effects of changes post-implementation. For example, after the new Accounting Act has been enforced, a thorough research should be conducted in two years' time to analyse the effect of changes on the transparency and reliability of SME financial statements – things that the Government believes decrease the most after implementing the new Accounting Directive. One is certain – Estonia should move towards involving SMEs in the standard setting process as they constitute a way too important part of the Estonian economy to not take their opinions into account.

The author recognises that its thesis like most of the studies concerning users has some **limitations**. Namely, in conducting the survey included in Chapter 4, firstly, the sample is not constructed by means of probability sampling. As it was not possible to construct a probability sample, non-probability sampling technique was used. Secondly, although the study is subject to relatively low response rate, the data presented provides a useful insight into the financial reporting needs of SMEs and the users and uses of their reports and the results have implications for Estonian and international regulators intending to issue new regulatory guidance for these entities. Thirdly, the survey only included 14 responses from medium-sized companies. Therefore, one could say that this group was underrepresented to compare it with micro and small entities and draw grounded conclusions about this size-group separately. Still, this does not diminish the value of the survey in general to provide insight to the SME financial reporting.

This thesis also includes **suggestions for future research**. Namely, the underexplored user group in the survey was banks and other lenders, which by other authors have been viewed as the main SME financial statement user group. The author recommends further research in this matter by targeting specifically representatives from the banks to understand, what are the main statements, indicators and ratios they use, when reviewing the SME financial statements for loan applications. In addition, mimetic institutional pressures were given less attention in this thesis. Future research should concentrate on the trading partners of the Estonian companies, whose requirements have to be met in order to increase the export. Also, other mimetic pressures should be identified.

The results of the thesis have **implications** for regulators who are now considering the possibility of developing guidance for the SMEs. From the EU perspective, this research can provide valuable insights for member states, how to implement the new Accounting Directive 2013/34/EU. In Estonia, the research is interest of organisations and individuals concerned with Estonian financial accounting guidelines (for example Estonian Ministry of Finance, Estonian Accounting Standards Board), as doctoral thesis contains observations on the Estonian current system of financial accounting concepts and relevant suggestions for the future. So in general, this doctoral thesis potentially contributes to the accounting reforms evidence in emerging economies, its progresses and obstacles.

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Appendix 1. Questionnaire

Survey among SME financial statement users and preparers

Dear respondent,

Tallinn University of Technology is carrying out a survey among Estonian SMEs to investigate about the current status of SME financial reporting and possible future trends.

Your responsens will provide important information to evaluate the effectiveness of the current financial reporting system and provide recommendations for future improvements. This questionnaire is part of a doctoral thesis, which investigates the preparation and uses of SME financial statements in Estonia.

It takes approximately 45 minutes to fill in the questionnaire. The anonymity of all respondents is guaranteed. The questionnaire is open until December 20, 2014.

If you wish, you can add your e-mail address in the end of the survey, so we can share the results of the survey with you.

Kind regards,

Liis Talpas (PhD student),
Tallinn University of Technology, Tallinn School of Economics and Business Administration, Chair of Financial Accounting

Lehte Alver (Professor),
Tallinn University of Technology, Tallinn School of Economics and Business Administration, Chair of Financial Accounting

1. Information about the company

1. The main financial figures of the company. This information is important to assess, into which company size group (micro-, small- or medium-sized entity) you as the respondent belomg to.

Sales revenue 2012:	
Sales revenue 2013:	
Total assets 2012:	
Total assets 2013:	
Average number of employees 2012:	
Average number of employees 2013:	

2. Preparation of the SME financial statements

2. Your company's annual report are prepared in accordance with (one option):
   - Estonian Accounting Standards Board Guidelines (ASBGs)
   - International Financial Reporting Standars (IFRSs)
   - Other (which)?

     ………………………………………………………………………..………

3. Have the new ASBGs effective from January 1, 2013 made the preparation of the annual report more complicated compared to previous standards (one option):
   - Yes - why?

     ……………………………………………………………..……………………

     No

4. Changes in the ASBGs (effective from January 1, 2013) that affected the preparation of company's annual report (multiple options):
   - Changes did not affect the company
   - Accounting for investment property
   - Accounting for goodwill
   - Accounting for financial assets in fair value
   - Accounting for associates
   - Accounting for assets held for sale
   - Capitalisation of development costs
   - Capitalisation of loan interest
   - Accounting for government grants
   - Accounting for connection fees
   - Not presenting third balance sheet when changing comparatives
   - Other (which one)?

     ……………………………………………………………..……………………

5. You familiarized yourself with the ASBGs effective from January 1, 2013, by (multiple options):

- Participating on training / course
- Reading the new ASBGs
- Reading the professional literature covering the subject matter
- Learning the subject matter in the university
- Getting information from company's auditor
- Other (how)?

  ………………………………………………………..……………………

6. Type of expenses the company incurs when preparing and filing the annual report (multiple options):
   - Salary of the accountant(s)
   - Salary of the chief financial officer (CFO)
   - Salary of the chief executive officer (CEO)
   - Fees paid to company's auditor
   - Fees paid to other consultants
   - Costs incurred in keeping up the IT-systems
   - Other (which)?

     ……………………………………………………………………..………

7. Expenses per year the company incurs in preparing and filing the annual report (one option):
   - The company does not incur any additional expenses
   - Up to 100 euros
   - 101 - 500 euros
   - 501 - 1 000 euros
   - Over 1 000 euros

8. Main users of the company's annual report to whom the company itself provides it (multiple options):

Owners	
Company's management	
Other employees of the company	
State (including Commercial Register, Tax authorities)	
Banks and other creditors	
Potential investors	
Trade creditors and suppliers	
Clients	
Competitors	
Consultants and financial analysts	
Credit rating agency (*Krediidiinfo*)	
Professional associations	
Other (who)?	

9. The main users of the company's annual report to whom the company does not provide it, but who are perceived to use them (multiple options):

Owners	
Company's management	
Other employees of the company	
State (including Commercial Register, Tax authorities)	
Banks and other creditors	
Potential investors	
Trade creditors and suppliers	
Clients	
Competitors	
Consultants and financial analysts	
Credit rating agency (*Krediidiinfo*)	
Professional associations	
Other (who)?	

10. The company is a part of the group (i.e. someones subsidiary or associate)::
    - Yes
    - No

If you responded "Yes" to the previous question, please also answer to questions 11 to 13.

11. Country, where the parent company is registered:
    ……………………………………………………………………………………….

12. Does the group has separate accounting policies in place, which regulate the preparation of company's financial statements:
    - Yes
    - No

13. If group accounting policies exist, which generally accepeted accounting principles they follow (one option):
    - Estonian Accounting Standards Board Guidelines (ASBGs)
    - International Financial Reporting Standars (IFRSs)
    - International Financial Reporting Standars for SMEs (IFRS for SMEs)
    - US GAAP
    - Other (which)?
      …………………………………………………………………………..………

3. The information needs of users of SME financial statements

14. If you use the financial statements of other SMEs, what is the main user group you belong to (one option):
    - Competitor
    - Potential investor
    - Trade creditor
    - Client
    - Other (who)?

    ……………………………………………………..……………………

15. You receive information about other SMEs from (multiple options):
    - Commercial register
    - Information received directly from the company
    - Internet
    - Professional Association
    - Other (where)?

    ……………………………………………………..……………………

16. The main source of information for you about other SMEs is (multiple options):
    - Annual report of the company
    - Market researches / information from professional associations
    - Self-made queries and background searches about the company
    - Other (which one)?

    ……………………………………………………..……………………

17. Your company incurs additional expenses in gathering financial information about other SMEs:
    - Yes
    - No

18. Expenses per year your company incurs if gathering information about other SMEs (one option):
    - The company does not incur any additional expenses
    - Up to 50 euros
    - 51 - 100 euros
    - 101 - 500 euros
    - Over 500 euros

19. You gather information about other SMEs (one option):
    - Every day
    - Every week
    - Once a month

- Once in a quarter
- Semi annually
- Once in a year
- Less often
- Other (which?)

……………………………………………………..……………………

20. You use the SME financial statements for the following reason(s) (multiple options):
    - To investigate the solvency of the company
    - To compare the financial results of your own company against the competitor operating in the same industry
    - To issue short- or long-term loan
    - To reorganize the company
    - Other (which?)

……………………………………………………..……………………

21. You use the following information from financial statements of other SMEs (one option per item):

	Never	Sometimes	Often
Sales revenue			
Cost of goods sold			
Operating expenses			
Staff expenses			
Depreciation, amortization and impairment of assets			
Gross profit (-loss)			
EBITDA (Earnings Before Interest, Taxes, Depreciation and Amortization)			
Operating profit (-loss)			
Net profit (-loss)			
Total current assets			
Total non-current assets			
Loan liabilities			
Payables and prepayments			
Accruals			
Total equity			
The compliance of equity to the Commercial Law			
Cash flows from operating activities			
Cash flows used in investing activities			
Cash flows used in financing activities			

Financial ratios			
Notes related to significant profit and loss statement line items			
Notes related to significant balance sheet line items			
Accounting policies			
Independent auditor’s report			
Management report			
One-off income and expense line items			

22. In addition you use the following information:

…………………………………………………………..……………………

4. Preparation of SME financial statements

23. Please evaluate the annual reports of SMEs:

	1 – Bad	2 – Poor	3 – Satis-factory	4 - Good	5 – Very good
The availability of financial information is:					
The reliability and usefulness of financial information is:					
The comparability of financial statements of companies operating in the same field of activity:					

24. Estonian Accounting Act (EAA) should include different financial reporting requirements for the following company size-groups (multiple options):
    - For micro companies
    - For small companies
    - For medium-sized companies
    - For large companies
    - For none of the above, because current EAA satisifies the needs of all companies

25. There is a need for unified financial reporting rules in European Union for the following company size-groups (märkida sobivad variandid):
    - For micro companies
    - For small companies
    - For medium-sized companies

- For large companies
- For none of the above, because each member state should decide itself over the legal requirements governing financial reporting

26. In order for the user to be able to make informed decisions about the SME financial statements, the SME annual report should include as minimum the following information about the balance sheet (multiple options):

Cash and cash equivalents	
Financial investments	
Receivables and prepayments	
Inventories	
Total current assets	
Biological assets	
Shares of subsidiaries and associates	
Investment property	
Property, plant and equipment	
Intangible assets	
Total non-current assets	
Borrowings	
Payables and prepayments	
Provisions	
Government grants	
Total current liabilities	
Total non-current liabilities	
Share capital	
Share premium	
Treasury units or shares (minus)	
Statutory reserve capital	
Other reserves	
Retained earnings (accumulated loss)	
Net profit (loss) for financial year	
Total equity	
All of the financial statement line items included above	

27. In order for the user to be able to make informed decisions about the SME financial statements, the SME annual report should include as minimum the following information about the income statement (multiple options):

Net sales	
Other operating income	
Changes in inventories of finished goods and work-in-progress	
Work performed by an entity for its own purpose and capitalised	
Goods, raw materials and services	
operating expenses	

Staff costs	
Depreciation and impairment of non-current assets	
Miscellaneous expenses	
Operating profit (loss)	
Financial income and expenses from subsidiaries and associates	
Financial income and expenses from financial investments	
Interest expenses	
Other financial income and expenses	
Profit (loss) before tax	
Corporate income tax expense	
Net profit (loss) for financial year	
All of the financial statement line items included above	

28. In order for the user to be able to make informed decisions about the SME financial statements, the SME annual report should include as minimum the following information in the notes (multiple options):

Analysis of net sales by geographic regions	
Contingent liabilities and assets	
Events after the balancse sheet date	
Fair value of property, plant and equipment	
Foreign currency transactions	
Information about benefits given and fees paid to employees	
Information about business combinations	
Information about long-term service and construction contracts	
Information about research and development costs	
Information about significant loans and their terms	
New services and products planned in the immediate future	
Number of employees	
Quality certificates (for example ISO)	
Related party balances and transactions	
Relevant terms of finance lease contracts	
Relevant terms of operating lease contracts	
Share based payments	
Significant inputs of goodwill impairment tests	
Social responsibility reporting	
The amount of granted or received guarantees or collaterals	
The book value of assets leased under finance lease terms	
The division of employees between white- and blue-collars	
The significant investments planned in the immediate future	
Other	

5. New Accounting Directive 2013/34 of European Union

29. Have you read / are you familiar Accounting Directive 2013/34 EU?
    - Yes
    - No

30. Do you believe that the requirements included in the Accounting Directive 2013/34EU in respect of SMEs are reasonable or not? Please evaluate the following statements.

    Requirements included in the Accounting Directive 2013/34EU for micro companies, if Estonia decides to incoprorate these in the EAA (PLEASE ALSO REVIEW THE BALANCE SHEET AND INCOME STATEMENT SCHEMES FOR MICRO COMPANIES):

Requirements for micro entities	Considered reasonable	Not considered reasonable	Hard to say
Opportunity to prepare an abridged balance sheet			
Opportunity to prepare an abridged income statement			
May be exempted from drawing up notes to the financial statements if the following information is disclosed in the end of the balance sheet – the total amount of any financial commitments, guarantees or contingencies that are not included in the balance sheet, the amount of advances granted to members of the administrative, managerial and supervisory bodies, with indications of the interest rates, main conditions and any amounts repaid or written off or waived, and information about transactions with own shares			
May be exempted from the obligation to prepare a management report, when information about transactions with own shares is disclosed somewhere in the financial statements			
May be exempted from using fair value system of accounting			
May be exempted from the obligation to publish annual financial statements provided that the balance sheet information contained therein is duly filed in accordance with national law			

31. Requirements included in the Accounting Directive 2013/34EU for small companies, if Estonia decides to incoprorate these in the EAA (PLEASE ALSO REVIEW THE BALANCE SHEET AND INCOME STATEMENT SCHEMES FOR SMALL COMPANIES):

Requirements for small entities	Considered reasonable	Not considered reasonable	Hard to say
Opportunity to prepare an abridged balance sheet			
Opportunity to prepare an abridged income statement that starts with gross profit (loss)			
Are required to present only a limited number of notes to the financial statements (including accounting policies adopted, revalued amounts of fixed assets, financial instruments and/or assets other than financial instruments are measured at fair value, the total amount of any financial commitments, guarantees or contingencies that are not included in the balance sheet, the amount of advances granted to members of the administrative, managerial and supervisory bodies, the amount and nature of individual items of income or expenditure which are of exceptional size or incidence; the average number of employees during the financial year)			
May be exempted from the obligation to prepare a management report, when information about transactions with own shares is disclosed in the financial statements, or if they prepare management report, they are not obligated to include financial information			
Have to file to the Commercial Register only an abridged balance sheet, an abridged income statement, an abridged management report and limited number of notes to the financial statement			
Member States may exempt small undertakings from the obligation to publish their income statement and management report			

32. Evaluate the requirements included in the Accounting Directive 2013/34EU for SMEs:

	Considered reasonable	Not considered reasonable	Hard to say
SMEs do not have to prepare and present the cash flow statement			
SMEs do not have to prepare and present the statement of changes in equity			

6. Other questions

33. Have you or the company you work for made recommendations for Estonian Accounting Standard Board to change/amend the ASBGs:
    - Yes – in relation to what?

    …………………………………………………………..……………………..
    - No

34. If you answered “No“ to the previous question, what do you think is the main reason hindering the participation of SMEs in standard setting process (multiple options):
    - SMEs do not realise that they can actively participate and influence the development process
    - SMEs are not be aware of the importance of participation or its potential benefits
    - Lack of resources (money, time, skills and knowledge)
    - Belief that the participation of SMEs is not needed, because the decisions are based on what large companies want
    - Belief that the participation of SMEs is not needed, because the decisions are based on what the government wants
    - Other (which)?

      ………………………………………………………..……………………

35. If you wish to add additional comments in respect of the preparation and presentation of the SME financial statement and legislation regulating it, please include it in here:

    …………………………………………………………..………………………

7. General information

36. Sex:
    - Man
    - Woman

37. Age:
    - Below 20 years
    - 20-29 years
    - 30-39 years
    - 40-49 years
    - 50-60 years
    - Over 60 years

38. Your main field of activity:
    - Chief Executive Officer
    - Chief Financial Officer
    - Accountant
    - Auditor
    - Consultant
    - Other (who?)

39. Work experience in your field of activity:
    - Below 1 year
    - 1-5 years
    - 6-10 years
    - 11-15 years
    - 16-20 years
    - Over 20 years

40. E-mail address[20]:
    ……………………………………………………………………………………

If you have additional questions, comments or recommendations, please contact liis.talpas@gmail.com

[20] Please fill in the e-mail address if you wish to receive the survey results afterwards.

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Liis Talpas
December, 2015

KOKKUVÕTE

Finantsaruanded on peamine viis ettevõtte finantsinformatsiooni edastamiseks ettevõtte välistele huvirühmadele. Sellest tulenevalt on oluline, kuidas ettevõte koostab ja esitab oma finantsinformatsiooni. Doktoritöö eesmärk on uurida, kas ja kuidas praegused raamatupidamisstandardid rahuldavad mikro-, väike- ja keskettevõtete (VKE) finantsaruannete kasutajaid ning millised on finantsaruanded, mis VKEdele sobivad.

Mainitud eesmärgi saavutamiseks uuris autor finantsaruannete koostamist kolmest vaatenurgast lähtuvalt. Esiteks, kas finantsaruannete koostamise aluseks peab olema mingi üldlevinud „finantsaruandluse teooria"? Teiseks, juhul kui finantsaruandeid pole võimalik koostada lähtudes üldlevinud teooriast, siis millised institutsionaalsed tegurid mõjutavad raamatupidamisstandardite kujunemist ja finantsaruannete koostamist? Ja kolmandaks, mida VKE finantsaruannete kasutajad ise soovivad finantsaruannetes näha?

Kuigi VKEde vajaduste uurimine ei ole maailmas uus nähtus, on sellele endistes Nõukogude Liidu vabariikides (sh Eestis) pööratud vähe tähelepanu. Seega on käesolev doktoritöö oluline mõistmaks, millised tegurid mõjutavad finantsaruandluse raamistiku kujunemist Eestis, et nendega arvestada raamatupidamise seaduse ja standardite koostamisel.

Doktoritöö esimene uurimisküsimus oli: kas eksisteerib „finantsaruandluse teooria" ja kas Eesti finantsaruandluse standardid peaksid seda järgima? Sellele küsimusele vastamiseks analüüsis autor mitmeid teooriaid (sh omanikuteooriat, majandusüksuse teooriat jt).

Doktoritöö esimeses peatükis:

- on antud ülevaade eri ajajärkudel valitsenud omakapitali teooriatest. Joonisel 2 on näidatud, millisel ajajärgul mingi omakapitali teooria kehtis ning millist huvigruppi käsitleti peamise finantsaruannete kasutajana.
- on antud ülevaade sellest, kuidas on rakendanud omakapitali teooriaid Rahvusvaheline Arvestusstandardite Toimkond (IASB) ja USA Finantsaruandluse Standardite Toimkond (FASB) nende koostatud kontseptuaalsetes raamistikes.
- lähtudes omakapitali teooriatest on analüüsitud Eesti Raamatupidamise seadust ja Raamatupidamise Toimkonna juhendeid (RTJ).

Doktoritöös käsitletud teooria ülevaade näitas, et juhul kui Eesti otsustab rakendada uusi finantsaruandluse standardeid või koostada uut raamatupidamise seadust, siis parim viis mõistmaks, mis on Eestile sobilik, on teha uuring finantsaruannete kasutajate hulgas. Mainitud uuring aitaks arvesse võtta kohalikke eripärasid (näiteks Eestis majandusele iseloomulikku suurt VKEde arvu). Eestil on keeruline luua oma

„finantsaruandluse teooriat”, kuna Eesti raamatupidamist ja finantsaruannete koostamist puudutav ajalugu on lühike ning seetõttu pole ka piisavalt ressursse ja kogemusi oma „finantsaruandluse teooria” loomiseks.

Doktoritöö teises peatükis uuris autor, millised on institutsionaalsed surved, mis mõjutavad Eestis finantsaruandluse raamistiku kujunemist. Analüüs tugines Ameerika sotsioloogide Powelli ja DiMaggio (1983) loodud institutsionaalsele teooriale. Eesmärgi saavutamiseks uuris doktoritöö autor põhjalikult Eesti Raamatupidamise seadust ja RTJe perioodil 1990–2012. Uuringu tulemusena selgus, et kui on soov Eesti VKEde finantsaruannete koostamist reguleerivat seadustikku parendada, siis peab alati arvestama Euroopa Liidu mõjudega. Nimelt on viimane oluline sundiv institutsionaalne surve, mis mõjutab Eesti seadusloomet. Lisaks Euroopa Liidule on Eesti jaoks olulised ka IASB ja IFRS-id. Normatiivse institutsionaalse surve esindajad Eestis on “Big4” audiitorbürood, kes auditeerivad enamikku Eesti avaliku huvi üksustest ja võivad niiviisi mõjutada finantsaruannete koostamise “parimat praktikat”, mida järgivad ka VKEd. Doktoritöös on vähem tähelepanu pööratud imiteerivale institutsionaalsele survele, kuid viimasena saab käsitleda näiteks ka Eesti ettevõtete rahvusvaheliste koostööpartnerite soove finantsinformatsiooni esitamise kohta, mida on mõistlik arvestada, et suurendada näiteks eksporti.

Doktoritöö üks eesmärk oli tuua välja, millised oleksid VKEdele sobivad finantsaruannete osad. Selle eesmärgi saavutamiseks tuli vastata järgmistele uurimisküsimustele:

- kes on Eesti VKEde finantsaruannete kasutajad ning millist informatsiooni soovivad nii kasutajad kui ka koostajad näha VKEde finantsaruannetes?
- kas kasutajate vajadused selle kohta, mida finantsaruannetes soovitakse näha, on erinevad või mitte?
- millistest osadest peaksid koosnema finantsaruanded, mis rahuldaksid Eesti VKEde vajadusi?

Doktoritöö autor teostas uuringu VKEde hulgas ning võrdles uuringu tulemusi nende finantsaruannete koostamise nõuetega, mis on toodud praegu kehtivas Raamatupidamise seaduses, Euroopa Liidu uues Raamatupidamisdirektiivis 2013/34/EL, Riigikogule esitatud Raamatupidamise seaduse eelnõus (mida 2015. aasta oktoobrikuu seisuga polnud Riigikogu vastu võtnud) ja teistes Euroopa Liidu liikmesriikide seadustes.

Kokku vastas uuringus toodud küsimustele 93 ettevõtet: 39 mikro-, 40 väike- ja 14 keskettevõtet. Autor möönab, et antud uuringul, nagu ka varem mujal läbi viidud finantsaruannete kasutajaid puudutavatel uuringutel, olid teatud piirangud. See ei vähenda aga uuringu väärtust andmaks ülevaadet VKEde finantsaruannete koostamisest ja kasutamisest.

Kokkuvõtteks võib märkida, et Eesti VKEd on Eestis kehtivate finantsaruandluse standarditega (st Raamatupidamise Hea Tavaga) rahul. 1. jaanuaril 2013 kehtima hakanud uued RTJid ei mõjutanud 68% uuringus osalenute arvates ettevõtte finantsaruannete koostamist võrreldes varem kehtinud standarditega. Need ettevõtted, keda uued RTJid mõjutasid, märkisid, et kõige suurem erinevus uute ja vanade standardite vahel tulenes kinnisvarainvesteeringute ja sihtfinantseerimise kajastamisest. Juhul, kui Raamatupidamise Toimkond peaks ka edaspidi RTJe muutma, siis võiks autori arvates läbi viia tasuta koolitusi, mis tutvustaks toimunud muudatusi ning aitaks selgitada, kuidas uusi nõudeid praktikas rakendada.

Samas tuleb rõhutada, et uuringus osalenud VKEd pole kunagi osalenud Raamatupidamise Hea Tava muutmises. Uuringus on välja selgitatud põhjused, mis takistavad Eesti VKEdel osalemast seadusloomes ja finantsaruandluse raamistiku kujundamisel. Need on järgmised:

- ei teadvustata, et VKEd saavad aktiivselt osaleda standardite koostamisprotsessis;
- VKEdel puuduvad vajalikud ressursid (aeg, raha, teadmised ja oskused) standardite koostamisprotsessis osalemiseks;
- ollakse arvamusel, et VKEde osalemine seadusloomes ei ole vajalik, kuna lõppkokkuvõttes kehtestab riik niikuinii endale sobivad nõuded.

Eelnevast tulenevalt soovitab doktoritöö autor Rahandusministeeriumil korraldada infopäevi, mis tutvustaksid eesseisvaid muudatusi seadustes ning kutsuksid osalejaid standardite muutmisprotsessis kaasa rääkima. Kuigi Rahandusministeerium tegi 2014. aasta kevadel uuringu, kus ühe alamteemana käsitleti uue Raamatupidamisdirektiivi 2013/34/EL rakendamist Eestis, siis doktoritöö autori hinnangul ei olnud mainitud uuring piisavalt läbipaistev ning sisaldas liiga palju kindlate huvigruppide vastuseid (audiitorid, avalik sektor). Seepärast soovitab doktoritöö autor tulevastes uuringutes:

- pöörata rohkem tähelepanud õigete huvigruppide kaasamisele;
- kaasata uuringute teostamiseks kolmandaid osapooli (näiteks ülikoolid, erasektor), kellel on varasem kogemus sarnaste uuringute teostamisel;
- kasutada uurimismeetodina fookusgrupi uuringuid või intervjuusid, mis võivad anda paremat sisendit uurimisküsimustele vastamiseks kui internetipõhised küsimustikud.

Doktoritöö autori tehtud uuringust selgus, et VKEde finantsaruannete kasutajad, kellele ettevõtted esitavad finantsaruandeid, on omanikud, juhtkond, riik (sh Äriregister, Maksu- ja Tolliamet) ja pangad. VKEde finantsaruannete kasutajad, kellele ettevõtted enda kohta infot ei edasta, kuid kes seda siiski kasutavad, on peamiselt konkurendid.

Kui VKEd koguvad informatsiooni teiste VKEde kohta, siis on kõige olulisem infoallikas Äriregister, mis sisaldab ettevõtete majandusaasta aruandeid. Lisaks saavad ettevõtted informatsiooni Internetist ja Krediidiinfost. Uuringust selgus, et ettevõte kulutab teiste VKEde kohta info kogumiseks keskmiselt 50 eurot aastas ning teeb seda tavaliselt üks kord kvartalis. Eelnevast tulenevalt soovitab doktoritöö autor, et päringute tegemine Äriregistrisse (sh majandusaasta aruande vaatamine) oleks tasuta, kuna Äriregistris sisalduv teave on huvitatud osapooltele peamine infoallikas.

Kui VKEd analüüsivad teiste VKEde finantsaruandeid, pööratakse kõige enam tähelepanu kasumiaruandele ja selle kirjetele. Esmajärjekorras vaadatakse müügitulu, puhaskasumit (-kahjumit), brutokasumit (-kahjumit), ärikasumit (-kahjumit) ja tööjõukulusid. Kasumiaruande kasutamine näitab, et Eesti VKEd toetavad majandusüksuse kontseptsiooni kasutamist finantsaruannete koostamisel. Lisaks leidis tõestust, et Eesti mikroettevõtted pööravad finantsaruannete teatud kirjetele vähem tähelepanu kui väike- ja keskettevõtted (st nende ettevõtete vajadused on erinevad). Mikroettevõtted pööravad vähem tähelepanu sellistele finantsaruannete osadele ja kirjetele nagu EBITDA, puhaskasum (-kahjum), kasumiaruandega seotud lisad ja omakapital kokku. Saadud tulemus toetab nimetatud suurusgrupi vabastamist nõudest koostada põhiaruannete olulistele kirjetele lisasid, nagu on välja pakutud Raamatupidamisdirektiivis 2013/34/EL.

Lisaks põhiaruannetele soovivad VKEd näha finantsaruannetes veel järgmist informatsiooni: töötajate keskmine arv, teave ettevõtte saadud laenude ja nende oluliste tingimuste kohta ning müügitulu geograafiliste piirkondade lõikes.

Tulenevalt teoreetilisest käsitlusest ja tuginedes uuringule, on autor koostanud VKEdele mõeldud täieliku finantsaruande mudeli (toodud Tabelis 54). Mikro- ja väikeettevõtete finantsaruanded peaksid sisaldama järgmisi osasid: lühendatud bilanss, lühendatud kasumiaruanne ja piiratud arv lisasid. Mainitud ettevõtted ei peaks koostama tegevusaruannet, rahavoogude aruannet ja omakapitali muutuste aruannet. Nii mikro- kui ka väikeettevõtete puhul peaks bilanss sisaldama täpselt neid kirjeid, mis on toodud Raamatupidamisdirektiivis 2013/34/EL (vt Tabel 5). Mikro- ja väikeettevõtete puhul peab ka kasumiaruanne sisaldama neid kirjeid, mis on toodud Raamatupidamisdirektiivis 2013/34/EL (vt Tabel 6), kuid väikeettevõtete puhul ei tohiks kasumiaruanne alata brutokasumiga, mis on üks Raamatupidamisdirektiivis 2013/34/EL lubatud variante. Nimelt näitas uuring, et kasutajatele on kõige olulisem kirje teise VKE finantsaruannete analüüsimisel müügitulu, mistõttu kasumiaruande alustamine brutokasumist kaotaks selle informatsiooni. Mikro- ja väikeettevõtted peaksid esitama Äriregistrile kõik finantsaruande osad, mida nad on kohustatud koostama. Keskettevõtete finantsaruanded peaksid olema koostatud täpselt samasugustel alustel nagu on nõutud praegu kehtivas Raamatupidamise seaduses.

Kuigi eksisteerivad mõned erinevused doktoritöö autori soovitatud VKEdele sobiva finantsaruannete raamistiku ja Raamatupidamise seaduse eelnõus toodud nõuete vahel, võib märkida, et Rahandusministeerium on teinud küllaltki õigeid soovitusi VKEdele, milliseid nõudeid rakendada. Samas soovitab doktoritöö autor pärast

Raamatupidamise seaduse muutmise eelnõu rakendamist teha VKEde hulgas mõne aasta pärast täiendav uuring, et kaardistada nende rahulolu kehtiva seadusega, mis võimaldaks vajadusel teha täiendusi, mis oleksid kooskõlas Raamatupidamisdirektiivis 2013/34/EL toodud nõuetega.

Doktoritöö autor on seisukohal, et Raamatupidamise seaduse muutmise eelnõus on tarvis kindlasti muuta mikroettevõtte definitsiooni, et võimalikult paljud ettevõtted saaksid koostada lühendatud finantsaruandeid. Praegune definitsioon lähtub osaliselt kvalitatiivsetest näitajatest (näiteks ei tohi ettevõte olla käibemaksukohustuslane), mis pole kooskõlas teistes Euroopa Liidu liikmesriikides levinud parima praktika ega Raamatupidamissirektiivis 2013/34/EL toodud soovitusliku definitsiooniga. Doktoritöö autor on seisukohal, et ka Eesti seadusesse rakendatav definitsioon peab kasutama mikroettevõtete defineerimisel müügitulu, bilansi mahtu ja töötajate arvu.

Doktoritöö autor leiab, et tulevaste uuringute teostamisel tuleb kaasata ka pangad ja muud finantsasutused, kuna paljude autorite uuringud on käsitlenud neid organisatsioone VKEde finantsaruannete peamiste kasutajatena. Sellest tulenevalt oleks huvitav teada, milliseid VKEde finantsaruandeid, kirjeid ja suhtarve jälgivad pangad VKEde laenutaotluste hindamisel. Lisaks ei käsitletud antud doktoritöös piisava põhjalikkusega imiteerivat institutsionaalset survet, millele tulevased uuringud võiksid rohkem tähelepanu pöörata.

Doktoritöö tulemusi saavad kasutada seadusloomega tegelejad ja organisatsioonid, kes koostavad finantsaruandluse standardeid VKEdele. Euroopa Liidus saavad doktoritöö tulemusi kasutada teised liikmesriigid hindamaks, kuidas uut Euroopa Liidu Raamatupidamisdirektiivi 2013/34/EL riiklikku seadusesse rakendada. Eestis saavad doktoritöös toodud soovitusi rakendada Rahandusministeerium ja Raamatupidamise Toimkond, kuna doktoritöö sisaldab tähelepanekuid praegu kehtivast süsteemist ning põhjalikku analüüsi Raamatupidamisdirektiivis ja Riigikogule esitatud uues Raamatupidamise seaduse eelnõus kehtestatud nõuetest. Teoreetilisest vaatenurgast annab doktoritöö ülevaate Eesti raamatupidamist puudutava seadusloome arengust kasutades selleks mitmesuguseid teooriaid ning tuues välja peamised takistused, arengukohad ja tuleviku perspektiivid.

ABSTRACT

How an entity presents information in its financial statements is very important because financial statements are a central feature of financial reporting – a principal means of communicating financial information to those outside an entity. Therefore, the doctoral thesis aimed at first to formulate an understanding how current and future accounting standards that govern the preparation of SMEs' financial statements expect to meet the needs of users. Secondly, how should a complete set of financial statements look like that satisfies the needs of Estonian stakeholders. Although analysing the needs of SME financial statements users and preparers is not new, its application is underexplored in the context of post-Soviet countries such as Estonia. This research is important to understand causes affecting the development if financial reporting system in emerging countries such as Estonia and take the possible influences into account when developing new accounting legislation in the future.

From the theoretical perspective, the thesis aimed to answer to the following research questions:

- Is there an "accounting theory"? Should it govern Estonian financial accounting framework and standards?
- What are the institutional pressures affecting the development of financial accounting framework in Estonia?

The theoretical analysis showed that when developing new accounting law, the best option for Estonia would be to analyse the local users and uses of financial statement taking into account the local context, for example large proportion of micro- and small entities. Still, we have to bear in mind that when we try to create rules or standards appropriate in the Estonian context, we need to juggle between the loopholes available in European Accounting Directive as European Union is an important institutional pressure affecting our national legislation, i.e. acting as coercive institutional pressure. In addition, the IASB and IFRSs play a profound role in Estonian accounting practice. In respect of normative institutional pressure in Estonia the "Big 4" firms audit most of the public interest entities and can therefore influence the preparation and presentation of their financial statements. Less attention was given to mimetic institutional pressures in this thesis. However, in the context of mimetic institutional pressure, the trading partners of the Estonian companies, whose requirements have to be met in order to increase the export, can be viewed.

The aim of the doctoral thesis was to formulate an understanding based on empirical research how should a complete set of SME financial statements look like. The results of the empirical research was benchmarked against current effective Accounting Act of Estonia, European Union new Accounting Directive 2013/34/EU, the Draft Bill of the new Accounting Act (not adopted by the Parliament in October 2015) and the legal requirements of other EU member states. To perform the analysis, the author carried out a study that aimed to answer to the following research questions:

- Who are the Estonian SME financial statement users and what information they utilise in analysing the SME financial statements?
- Are the users' needs different or not?
- How should a cohesive set of financial statements look like that satisfies the needs of SMEs and their financial statement users in Estonia?

To answer to these questions the author conducted a survey among Estonian SMEs. The total number of answers received in the empirical research was 93, which was divided between micro, small and medium sized companies as follows: 39 answers from micro entity representatives, 40 from small companies and 14 from medium-sized companies. The author recognises that this survey, like most of the studies concerning users, has some limitations, but still, this does not diminish the value of the survey in general to provide insight to the SME financial reporting.

In general, the current accounting legislation in respect of accounting policies governing the preparation of financial statements seems to satisfy the financial statement preparers. However, Estonian SMEs face barriers in realizing the benefits of accounting standards. The results of the survey show that nobody from the 93 respondents had ever participated in the standard setting process or made proposals to the EASB in respect of new guidelines.

The Estonian SME financial statement users, to whom the company itself provides the financial statements, are considered to be owners, company's management, state (including Commercial Register, Tax authorities), and banks and other creditors. The Estonian SME financial statement users, to whom the company does not provide the financial statements, but who are perceived to use them, are considered to be competitors. When users review the financial statements of other SMEs, they place the greatest emphasis on financial statement line items such as sales revenue, net profit (loss), gross profit (loss), operating profit (loss), and staff expenses. This shows that Estonian SME financial statement users place great importance on income statement, which indicates that the users support the entity view of the different equity theories.

It was also confirmed that small and medium-sized companies as financial statement users place more emphasis on some of the income statement line items than micro entities (namely EBITDA, net profit (loss), income statement related notes, total equity). It was also confirmed that Estonian micro companies perceive the availability, reliability, usefulness and comparability of financial statements differently than small and medium-sized companies.

In respect of the SME definitions set in Draft Bill of Estonian Accounting Act, the author firmly believes that the definition of micro entities should be revised allowing more Estonian companies to benefit from drafting abridged financial statements. Based on the results of survey and theoretical research, the author made a suggestion, how should a complete set of financial statements look like that satisfies the needs of SME financial statement users.

ELULOOKIRJELDUS

1. Isikuandmed

Ees- ja perekonnanimi	Liis Talpas
Sünniaeg ja -koht	06.03.1987 Jõgeva
Kodakondsus	Eesti
E-posti aadress	liis.talpas@gmail.com

2. Hariduskäik

Õppeasutus (nimetus lõpetamise ajal)	Lõpetamise aeg	Haridus (eriala/kraad)
Tallinna Tehnikaülikool	2010–2016	Ärikorraldus, Doktorikraad
Tallinna Tehnikaülikool	2010	Majandusteaduskond, arvestuse õppesuund, sotsiaalteaduste magister (*cum laude*)
Tallinna Tehnikaülikool	2008	Majandusteaduskond, arvestuse õppesuund, bakalaureusekraad (*cum laude*)
Puurmani Keskkool	2005	Keskharidus (kuldmedal)

3. Keelteoskus

Keel	Tase
Eesti keel	emakeel
Inglise keel	kõrgtase
Saksa keel	kesktase
Vene keel	algtase

4. Teenistuskäik

Töötamise aeg	Tööandja nimetus	Ametikoht
2015 – ….	AS PricewaterhouseCoopers	juhtivaudiitor
2013 – ….	AS PricewaterhouseCoopers	vandeaudiitor
2009 – 2013	AS PricewaterhouseCoopers	audiitori assistent
2008 – 2009	Eesti Advokatuur	raamatupidaja abi

5. Teadustegevus

Publikatsioonid

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Konverentsi ettekanded

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Teadusstipendium

Rahandusministeeriumi teadusstipendium (2012) doktoritöö teostamiseks.

6. Kaitstud lõputööd

Magistritöö: Liis Talpas (2010), Rahvusvahelise finantsaruandluse standardi IAS 1 muutmise projekt, Juhendaja Lehte Alver, Tallinna Tehnikaülikool

Bakalaureusetöö: Liis Talpas (2008), Kohalikud maksud Eesti Vabariigis aastatel 1994–2008. Juhendaja Kaidi Kallaste, Tallinna Tehnikaülikool

7. Teadusorganisatsiooniline töö

Euroopa Raamatupidamisassotsiatsiooni liige

CURRICULUM VITAE

1. Personal data

Name	Liis Talpas
Date and place of birth	06.03.1987 Jõgeva
Citizenship	Estonian
E-mail address	liis.talpas@gmail.com

2. Education

Educational institution	Graduation year	Education (field of study/degree)
Tallinn University of Technology	2010–2016	Doctor of Philosophy, PhD
Tallinn University of Technology	2010	Master of Arts in Social Sciences (cum laude)
Tallinn University of Technology	2008	Bachelor of Arts in Social Sciences (cum laude)
Secondary School of Puurmani	2005	Secondary education (gold medal)

3. Language competence/skills (fluent, average, basic skills)

Language	Level
Estonian	Native language
English	Fluent
German	Average
Russian	Basic skills

4. Professional employment

Period	Organisation	Position
2014 – ….	AS PricewaterhouseCoopers	Engagement Leader
2013 – ….	AS PricewaterhouseCoopers	Authorised Public Accountant
2009 – 2013	AS PricewaterhouseCoopers	Assistant to auditor
2008 – 2009	Estonian Bar Association	Assistant to accountant

5. Research activities, including honours and theses supervised

Publications

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Alver, L.; Alver, J.; Thomsen, J.; Sundgaard, E.; Talpas, L. (2013). Accounting Policy and Institutional Pressures in Subsidiaries: The Case of Estonia. *In: 3rd Annual International Conference on Accounting and Finance (AF 2013)*: 3rd Annual

International Conference on Accounting and Finance (AF 2013), Bangkok, 20–21 May 2013. , 17.

Conference presentations

Conference „9th International Conference on Accounting and Management Information Systems" (2014). Romania, the participant (article presented).

Conference „Business Analysis, Accounting, Taxes and Auditing" (2011), Estonia, the participant (article presented).

Conference „Raamatupidamiselt majandusarvestusele III" (2010), Estonia, the participant (article presented).

Research grant

Grant from the Ministry of Finance (2012) for research in PhD thesis.

6. Defended Thesis

Master's degree: Liis Talpas. The Amendment Project of the IAS 1. Supervisor professor Lehte Alver. Tallinn University of Technology, 2010.

Bachelor's degree: Liis Talpas. Local taxes in the Republic of Estonia in 1994–2008. Supervisor lecturer Kaidi Kallaste. Tallinn University of Technology, 2008.

7. Participation in scientific organisations

Member of European Accounting Association

DISSERTATIONS DEFENDED AT TALLINN UNIVERSITY OF TECHNOLOGY ON ECONOMICS AND BUSINESS ADMINISTRATION

1. **August Aarma**. Segmented Analysis of Bank Customers and Banking Information: Estonian Case. 2001.
2. **Enn Listra**. The Development and Structure of Banking Sector: Retail Banking in Estonia. 2001.
3. **Tatyana Põlajeva**. The Comparative Analysis of Market's Attractiveness. 2001.
4. **Tuuli Tammeraid**. Modeling Flow of Funds for Estonia. 2002.
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