SMALL COMPANY FINANCIAL REPORTING (SCFR): AN UPDATE BASED ON RECENT DEVELOPMENTS AND SELECTED GROUP PERCEPTIONS

(VOLUME II)

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Chapter 7

SURVEY OF ACCOUNTS

7.1 Introduction

The main objectives of the survey of a sample of SC accounts were:

i) to check whether or not certain disclosures in sample companies' accounts were consistent with various financial reporting requirements; and

ii) to collect background information for subsequent postal surveys of directors and auditors of SCs.

Research undertaken by Page (1981) and Carsberg et al (1985) focused on detailed surveys of SCs' full accounts. Robertson (1986a)'s survey extended beyond full accounts to consider the extent to which SCs took advantage of the option to file abbreviated accounts and extent of their disclosures.

The author's review of accounts, reported in this Chapter, considered the extent to which sample companies filed accounts on time because of public perception that timeliness assisted managerial decision-making on the part of interested parties. Furthermore, in an attempt to assess the appropriateness of the stewardship principle of reporting by directors to shareholders, the extent of shareholdings by the directors of sample companies was reviewed.

The review of accounts further examined the extent of audit qualification, disclosure of "additional information" in sample companies' accounts and use of the option by sample companies to file abbreviated accounts. Finally, an attempt was made to ascertain the extent of compliance by the sample companies with Companies Acts and SSAP requirements.

7.2 About the author (reviewer)

The author is a qualified accountant with 16 years experience in audit practice.

Prior to his review of accounts in March and April 1992 (and subsequently in February and March 1995), he worked for more than 5 years as a senior audit manager in a ten-partner firm of Chartered Accountants in London, responsible for a large portfolio of SC audit clients. He had also served as senior auditor with an international firm of Chartered Accountants for nearly 7 years.

He is currently practising as a sole-practitioner and his main area of speciality is in audit of SCs.

7.3 Sample selection

In an attempt to select a sample of SC accounts for review, the author had three possible options; namely:

i) to visit Companies House;

ii) to contact a sample of audit firms directly who could provide the required sample of accounts for review; or

iii) to seek help from professional colleagues in audit practice for the above purpose.

The first option (i.e. to visit Companies House) was abandoned because of the costs involved in obtaining the accounts and also because the intended comparisons of some sections of both full and abbreviated accounts (of a sample company which had prepared both sets) would not have been possible, since a SC is required to file either its full or abbreviated accounts.

The other two options involved first selecting a random sample of audit firms who would grant the author permission to review some of their SC clients' accounts. These are considered below.

Selection of audit firms

In considering the second option, a pilot sample of 10 audit practitioners in London (8 ACA and 2 ACCA) was selected randomly from the Yellow Pages. Senior partners of the firms were contacted by telephone, informed of the objectives of the survey and of CUBS's support for it. Unfortunately, all the firms declined to participate, presumably for fear of breaching their clients' confidentiality.

It was then decided to make use of the third option - to contact a sample of professional colleagues and their contacts in audit practice to enlist their support. Although it could be argued that this method of selection might provide a non-representative sample of audit firms, it was not felt that this would bias the subsequent random selection of their SC clients' accounts.

A total of 40 audit practitioners (32 ACA and 8 ACCA) from various audit firms in London were contacted by telephone. Of these, 21 practitioners (18 ACA and 3 ACCA) agreed to allow the author to carry out a review of their SC clients' accounts, subject to complete confidentiality being guaranteed.

In contrast to the first option, this one afforded the author the opportunity to discuss with the audit practitioners some aspects of SCFR.

Details relating to the audit firms' sample are given below.

Table 7.1: Number of partners in the audit firms' sample

	In sample No.	In sample %	Humphrey Turley (1986) %
1 (sole practitioner)	11	52	)
2 - 5	8	38	) 76.8
Over 5	2	10	23.2
	21	100	100

Table 7.2: Number of professional staff (excluding partners) in the audit firms' sample

	In sample No.	In sample %	Humphrey & Turley (1986) %
0 - 10	17	81	51.7
11 - 25	3	14	24.5
Over 25	1	5	23.8
	21	100	100.0

As can be seen from the above tables, the majority of firms were sole practitioners and in most cases, there were fewer than 10 employees in a firm. In fact, comparing the sample with that of Humphrey and Turley (1986), the sample had a higher number of "smaller" firms in terms of number of partners and professional staff, although precise comparison is difficult.

Selection of SC accounts

A practitioner from each firm was requested to select at random five small non-dormant company clients (as defined by the CA 1985 for filing abbreviated accounts) for the purpose of reviewing their latest published accounts. No group accounts were included in the sample. As already pointed out, although the method of selecting audit firms could arguably provide a non-representative sample of audit practitioners, this did not bias the subsequent random selection of accounts.

In total, 105 SC accounts were reviewed using checklists to ascertain whether certain disclosures in sample companies' accounts were consistent with company law, auditing and accounting standards requirements. Furthermore, the checklists were used to gather relevant information about the sample companies (e.g. principal activities, annual turnover, directors' shareholdings, etc.). A summary of the findings relating to the main sections of the checklists is presented in the tables in this Chapter.

The review exercise which took place during March and April 1992 was carried out in the firms' premises. Additional visits were also made in February and March 1995 to gather further information from the sample accounts. Details relating to the sample companies together with the results and analysis of the accounts' survey are presented in subsequent sections.

a) Principal activities of sample companies

A review of the directors' report in full accounts of the sample companies identified the following principal activities:

Table 7.3: Principal activities of sample companies

	No.	%
Manufacturing	19	18
Non-manufacturing		
- trading	54	52
- property	15	14
- other*	17	16
	105	100

* including travel agencies, printing, publishing and window glazing.

b) Annual turnover of sample companies

The analysis of turnover of sample companies as disclosed in their profit and loss account is given in the following table:

Table 7.4: Comparison of annual turnover of sample companies with "general population"

	Sample companies		"general population"
	No.	%	%
£1 - £0.25m	69	66	55
£0.25m - £0.5m	23	21	14
£0.5m - £1m	8	8	12
£1m - £2m	3	3	8
over £2m	2	2	11
	105	100	100

(Source for "general population" data: "Company size by turnover according to VAT (including building societies)", see Appendix C, Table 4 of DTI, 1994:8).

Comparing the annual turnover of sample companies with that of the "general population", there is a higher proportion of companies with annual turnover below £0.5m in the sample than in the "general population". This may indicate that the sample companies were relatively "smaller" than "average". It is worth noting that the rental income of property companies in the sample is treated as annual turnover.

It should be pointed out that there were 2 companies with annual turnover above £2m. Further review of the accounts of these companies indicated that their balance sheet total assets before deduction of any liabilities were less than £0.975m each and their average number of employees was less than 50.

7.4 The extent of the timeliness of filing accounts

Timeliness of filing of accounts by companies continues to be of interest because of its perceived effect upon the usefulness of information filed with the Registrar of Companies. Private companies are required by the CA 1985 (section 242) to file their accounts with the Registrar of Companies within 10 months of their accounting reference date.

It is not possible from the review of accounts to find out when the accounts are filed with the Registrar of Companies. However, a review of sample companies' accounting periods (being the latest accounting period) was useful to determine the number of companies in the sample which appeared to be late in filing their following year's accounts within the statutory time limit:

Table 7.5: The latest accounting period of sample companies ended in the following calendar year:

	No.	%
1988 and earlier years	4	4
1989	7	7
1990 - up to 30 April 1990	9	8
- 1.5.90 to 31.12.90	45	43
1991	40	38
1992 (review in March/April 1992)	-	-
	105	100

Assuming all the latest accounts of the sample companies had already been filed with the Registrar of Companies, there were 20 (19%) companies in the sample which were probably late in filing their following year's accounts. The companies with accounting periods ended before 30 April 1990 were likely to have been late in filing their following year's accounts because a company with the latest accounting period ended on 30 April 1990, for example, should have filed its following year's accounts (i.e. for the year ended 30 April 1991) by 29 February 1992. Thus, at the cut off date of 1 March 1992 (just before review), such a company was considered to be late in filing its following year's accounts.

Other studies, for example Page (1981) and Robertson (1986a), reported that 26% and 30% of their sample companies respectively had been late in filing their accounts. Comparing these results with those of this survey (i.e. 19%) there appears to be an improvement in the timeliness of filing accounts.

It is worth pointing out that automatic penalties for late filing of accounts came into force in July 1992 following complaints from users about the lack of up-to-date information (DTI, 1995:12). It has been suggested that this would improve both the level of compliance and the timeliness of filing (see for example DTI, 1991/92:19).

7.5 Directors' shareholdings in sample companies

The ownership and control of companies by directors is of great interest when assessing the appropriateness of the current reporting requirements, which are based on stewardship principle of reporting by directors to shareholders.

The directors' report gives each director's shareholdings in the company at the beginning (or at the date of their appointments if later) and at the end of the financial year. The extent of directors' shareholdings in a sample company was calculated by dividing the number of shares held by the directors into the number of shares issued by the company. On average, directors had total control in 71% of the sample companies and held more than 50% of the share capital in 93% of the sample companies. The following table gives the analysis of shareholdings by directors in the sample companies as compared with those of SBRC (1992):

Table 7.6: % of shareholdings held by the directors in the sample companies compared with SBRC (1992)

% of directors' shareholdings	sample companies		SBRC (1992) "All"
	No.	%	%
0	1	1	4.8
1 - 25	2	2	2.9
26 - 50	4	4	5.8
51 - 75	3	3	11.3
76 - 99	20	19	15.6
100	75	71	59.6
	105	100	100.0

(Source: extracted from SBRC (1992), see Cosh and Hughes, 1994:24).

The above table indicates that the majority of directors in the sample companies owned and controlled their companies. Furthermore, by comparing the sample companies' results with those of SBRC (1992), it can be seen that a higher proportion of sample companies (71%) had directors with full control and ownership than those (59.6%) of SBRC (1992). For further details of SBRC (1992), see section 6.3 - ownership and control.

From the above analysis, it is questionable whether the current reporting requirement, based on the stewardship principle of reporting by directors to shareholders, is appropriate for all SCs, where directors in the majority of cases report to themselves as shareholders.

7.6 Audit qualifications in sample companies

Generally speaking, the audit report is designed as a protection for accounts' users and it provides some indication of the reliability of the accounts. Where an auditor is unable to carry out procedures to obtain sufficient and reliable audit evidence, he should either qualify or disclaim his opinion.

The review of audit reports of sample companies identified 21 (20%) which had been qualified by their auditors. Table 7.7 gives details of the audit qualifications in reports of the sample companies.

Table 7.7: Audit report

	Sample companies	
	No.	%
Unqualified	84	80
Qualified for:		
- non-compliance with the CA requirements	3	3
- non-compliance with accounting standards	4	4
- lack of internal control and reliance on management assurances	6	6
- insufficient evidence to confirm a going concern	5	5
- insufficient evidence to verify assets/liabilities	1	1
- insufficient evidence to verify cash sales	1	1
- other	1	-
	105	100

As can be seen from the table, lack of internal control and insufficient evidence to confirm a going concern basis were the most common reasons given for audit qualifications in the sample companies' reports.

Comparing the total number of qualified audit reports in this sample (20%) with those of Carsberg et al (1985) (32%) and Robertson (1986a) (44%), it would appear that there has been a fall in the number of qualified audit reports.

Furthermore, comparing the 6% of sample companies in this survey (whose latest accounting periods ended in 1989 and earlier years) which received "small company audit qualification" with those of Carsberg et al (1985) (26%) and Robertson (1986a) (31%), there was a noticeable decrease in audit qualification which could possibly be explained by the fact that the old "Example 6" audit report (i.e. reliance on management assurances) had been widely used before its withdrawal in September 1989.

7.7 The extent of "additional information" disclosure

The Corporate Report (1975) recommends disclosure of additional information, such as an "employment report" or a "value added statement", in the published accounts for better understanding of the accounts.

The review of the sample companies' accounts did not identify any such additional information.

As a result of post-review discussions with audit practitioners about "additional information" disclosure, there appears to be a general consensus that the recommendations of the Corporate Report are more appropriate to larger companies' accounts.

7.8 Abbreviated accounts

The CA 1985 requires that all companies prepare full statutory accounts for their members. SCs, as defined by the CA 1985, may file abbreviated accounts (consisting of an abbreviated balance sheet and related notes in addition to a special auditors' report and directors' statements that they are entitled to the exemptions and that they have taken advantage of them).

It has been argued that abbreviated accounts may be worth filing "if there is a competitive or other advantage to be gained by not disclosing particular information" (DTI, 1995:12). Accordingly, the extent of filing abbreviated accounts was considered an important aspect of this survey.

Thirty seven (35%) companies in the sample prepared both full and abbreviated accounts and the remaining sample companies prepared only full accounts. Further enquiries confirmed that only sample companies which prepared abbreviated accounts availed themselves of the option to file them (35%) and no company filed both full and abbreviated accounts. This is comparable with the average number of SCs which filed their abbreviated accounts in 1991/1992 (DTI, 1994, Appendix C:Table 1):

Table 7.8: Type of accounts filed by sample companies

	Sample companies		Population
	No.	%	%
Filed SC abbreviated accounts	37	35	32.5
Filed full accounts	68	65	67.5
	105	100	100.0

It is interesting to note that in a recent report, the DTI (1995:12) disclosed that of the estimated 870,000 SCs on the register in 1993/94, only 308,800 companies filed abbreviated accounts. The report further refers to the compliance cost of preparing abbreviated accounts and argues that so few companies take advantage of the option to file abbreviated accounts "because it costs approximately £100 - £250 on top of the costs of preparing full accounts, to convert them to abbreviated accounts for filing".

7.9 Compliance with the CA 1985 requirements

The CA 1985 requires disclosure of certain items in the accounts of SCs. The extent of compliance with these requirements is of interest because a low level of compliance may reflect the burden imposed by such statutory disclosure requirements.

The extent of disclosure compliance was checked for certain items only in respect of both full and abbreviated accounts of sample companies.

Two checklists were prepared (one for full accounts and one for abbreviated ones) from certain requirements of the Act and used as a guide for appropriate disclosure requirements where individual (not group) accounts were prepared; the checklists did not purport to be complete. For the purpose of this review, more emphasis was placed on the review of abbreviated accounts, because earlier research (for example, Carsberg et al, 1985) had considered full accounts in detail.

The summary of the main findings is presented in the following tables with minimum comment on them.

Abbreviated accounts

Table 7.9: Compliance with Sch. 8 to the CA 1985 requirements (SC abbreviated accounts)

Minimum requirement by Sch. 8 to the CA 1985.	Number (out of 37)
* No profit and loss accounts	37
* No directors' report	37
* Special auditors' report	

- presented 37

- addressed to directors (see note (i) below) 32

- stated that company was entitled to the exemption 37

- stated that accounts were properly prepared in accordance with Sch. 8 CA 1985 35

- reproduced in full the text of the auditors' report on the full accounts to shareholders (see note (ii) below) 36

* Balance sheet - abbreviated version

  - only format headings with letter or roman number need be shown 32

  - directors' statement that advantage has been taken of the exemption conferred by Sch. 8 36

  - directors' statement that they have done so on the grounds that the company was entitled to the exemption 35

* Notes to the abbreviated accounts (Extract)

  - accounting policies were same as those in full accounts 35

  - fixed assets movement (only format headings with letter or roman number - i.e. movements in tangible fixed assets, intangible fixed assets and fixed asset investments for the categories in total) (see note (iii) below) 31

Notes

(i) Special auditors' reports were addressed to <u>shareholders</u> in 3 companies and to the <u>company</u> itself in 2 cases.

(ii) One company did not reproduce in full the text of the auditors' report on the full accounts to shareholders.

(iii) One company in the sample did not have fixed assets. The fixed asset notes of abbreviated accounts in five companies were identical to their full accounts note which provided more information than required by Sch. 8 CA 1985.

Full accounts

Table 7.10: Compliance with the CA 1985 requirements (full accounts)

	Number (out of 105)
* Directors' report	
- names of directors during financial year	105
- principal activities	105
- directors' share interest	105
- a fair review of the business	88
* notes to the accounts	
- accounting policies note	105
- basis of valuation of stocks (see note below)	92
- auditors' remuneration	105
- directors' emoluments	104
- average number of employees	83

(Note: 5 companies had no stocks and 8 companies appeared to have failed to disclose the basis of valuation for stocks).

7.10 Compliance with Statements of Standard Accounting Practice (SSAPs)

For the purpose of this review a checklist of certain basic disclosures required by some "basic" SSAPs was used, compliance with which should have been evident on the face of the accounts. The main findings of the review in respect of some "basic" SSAPs are summarised below:

SSAP 2: Disclosure of accounting policies
All the companies in the sample disclosed their accounting policies note. However, this note was not considered to be complete; for example, 8 companies in the sample appeared to have failed to disclose the basis of valuation of stocks.

SSAP 6: Extraordinary items and prior year adjustments
Five companies in the sample had extraordinary items, correctly shown below profit after tax in the profit and loss account. However, two of those companies appeared to have failed to disclose them by way of a note to the accounts.

Furthermore, there were two prior year adjustments arising from the correction of fundamental errors in prior years, which had been corrected against the opening balance of "retained profit brought forward" in the profit and loss accounts. These items were also disclosed in the note to the accounts.

SSAP 9: Stocks and long term contracts
Five companies in the sample had no stocks. Eight companies appeared to have failed to disclose the basis of valuation of stocks. Furthermore, of 100 companies which had stocks, 27 companies apparently failed to disclose the analysis of stocks by category (i.e. raw material, work in progress and finished goods).

SSAP 10: Statements of source and application of funds
Accounts were reviewed to ascertain whether all companies with turnover above £25,000 had prepared a fund

statement. Four companies failed to produce fund statements, of which only two received a qualified audit report for this reason.

Furthermore, an attempt was made to identify whether any company with turnover under £25,000 had prepared a fund statement. Three companies were found to have produced fund statements despite the fact that they were exempt from the SSAP 10 requirement. However, these companies filed their abbreviated accounts (without fund statements) with the Registrar of Companies. Therefore, it cannot be argued that these companies provided any "additional information" (see section 7.7) in their published accounts.

SSAP 12: Accounting for depreciation

Compliance with SSAP 12 has been considered in detail by previous research (Carsberg et al, 1985:73 and Robertson, 1986a:19).

This review considered only the extent of depreciation of buildings in the sample companies. Sixty eight (65%) companies in the sample had buildings, of which 37 were classified as investment properties (see below) which were exempt from the SSAP 12 requirements for depreciation (except for properties held on lease when the unexpired term is 20 years or less (SSAP 19, Para. 10) - this could not be checked from the accounts).

Of the remaining (31) companies which had buildings subject to SSAP 12 requirements, 9 companies apparently failed to depreciate their buildings, some on the grounds that market values exceeded book values. Of these, only two companies received an audit qualification for non-compliance with SSAP 12 requirements and Schedule 4 to the CA 1985.

These multiple qualifications are treated as non-compliance with CA requirements (rather than accounting standards) in Table 7.7.

SSAP 19: Accounting for investment properties
SSAP 19 requires that investment properties should be included in the balance sheet at their "open market value" (see SSAP 19:para. 11). Of 37 companies (see above) which had investment properties, two received an audit qualification for non-compliance with this requirement.

7.11 Summary and conclusion

The main findings of the accounts review broadly indicate, within the context of the sample companies which were considered to be relatively "smaller" than "average", that:

* a minority (19%) of the sample companies were late in filing their following year's accounts. However, in comparing this result with those of other studies, it appears that there is an improvement (i.e. a greater level of compliance) in filing of accounts within statutory time limit by the companies;

* in the majority (71%) of the sample companies, directors and shareholders were identical, with the effect of bringing into question the appropriateness of the requirement for directors to report to shareholders;

* the majority (80%) of the companies in the survey had unqualified audit reports on their latest published accounts. Furthermore, comparing this finding with those of other studies (for example, Robertson, 1986a), it seems that there has been a fall in the

number of qualified audit reports for SCs;

* the sample companies did not disclose any "additional information" in their accounts;

* only 35% of the sample companies which were entitled to file abbreviated accounts availed themselves of this option. It has been claimed that because of additional costs for preparing abbreviated accounts, many SCs do not take advantage of this option (DTI, 1995); and

* the extent of non-compliance with the CA and the "basic" SSAPs requirements did not appear to be widespread.

The next Chapter considers the main findings of the directors' survey which also provides support for some of the above findings.

CHAPTER 8

SURVEY OF DIRECTORS

8.1 Introduction

The main objective of the survey was to ascertain the views of directors (and shareholders) of private SCs about certain SCFR issues. In particular, the survey examined the extent of ownership and control of the sample companies by their directors (and their families) in order to assess whether the current reporting requirement was appropriate for such companies.

The directors' views about the main advantages and disadvantages they derived from running their business as a company rather than as a partnership or as a sole-proprietor were sought. Furthermore, their opinions about the main users and the perceived usefulness of annual accounts, for example, for assessing financial aspects of other companies, making business and management decisions, were investigated.

This survey paid particular attention to form and content of SC accounts by investigating whether "one set of accounts" should replace both full and abbreviated accounts for SCs. Possible benefits and contents of such accounts were further investigated.

The accountants' role in SCs and the importance of their services were considered. Finally, the survey examined the sample directors' attitudes to certain SC audit issues such as the perceived benefits of annual audit and possible changes in SC audit requirement.

With these in mind, questionnaires were sent to a sample of 375 directors of SCs in November 1992. One hundred and six analysable responses were received, (a response rate of 28.3%) which was considered satisfactory for this type of survey (see 6.5). The "% of respondents" in this Chapter refers to the percentages of 106 directors who responded to the questionnaires. The survey was sponsored by the CUBS and supported by the LSCA.

The sample of directors was selected with help of their auditors. To do that, a sample of 375 auditors were randomly selected from the LSCA's known Practitioner Members List. They were sent two different sets of questionnaires with a covering letter requesting that they complete the auditors' questionnaires and forward the directors' questionnaires to one of their clients' directors. In response to a follow-up to the survey, the auditors claimed they had selected their clients from those they considered "reliable" to complete the questionnaires or "interested" in the SC audit debate or on a random basis from their SC clients.

Further investigation indicated that the majority of the auditors had, in addition to the LSCA's covering letter, sent their own covering letter or a piece of note with the questionnaires.

It is worth noting that in comparing the above sample with the general population of SCs, it could possibly be concluded, with some caution, that sample companies were "bigger" than "average" in terms of turnover and employment distributions. Furthermore, the boards of the sample companies appear to have "greater" ownership (and control) of their companies than "average". For further details of the sample selection see section 6.3.

The major findings of the directors' survey are reported in the body of this Chapter, while others are cross-referenced to the <u>tables</u> in the <u>Supplement</u> to this

Chapter, which provides the full list of responses to the Directors' Questionnaire in Appendix 2. For ease of cross-referencing, the same notation has been used. For example, DQ2.3 refers to question 2.3 in the Directors' Questionnaire and also to directors' responses in Table DQ2.3 in the Supplement.

Where appropriate, the findings of this survey have been compared with Page (1981)'s results, to ascertain the extent of changes in directors' attitudes towards SCFR issues over the last decade.

The cross-analysis of the primary findings and the testing of the research hypotheses are presented in Chapter 10, which provide the basis for statistically valid generalisations about the consistency of these results. Finally, Chapter 11 provides some comparisons of the findings of this survey with those of the auditors' survey (Chapter 9).

8.2 Respondents

The respondents were considered a good representative sample of private companies' directors and shareholders, as they comprised directors with diverse areas of expertise, and varying levels of accounting experience, as well as other areas which are SC oriented. An overview of the respondents' profile is provided below.

Their areas of expertise were claimed to be in technical (19%), commercial (36%), financial (25%), other professional (8%) and others (12%) (DQ1.3). They also claimed to have different levels of accounting experience, namely: accountancy qualification (21%), courses in accounting (16%), book-keeping experience (25%) and little or no accounting experience (38%) (DQ1.5).

The respondents were mainly aged between 30 and 60 years old (DQ1.2) and the majority (71%) reported that their work within the company constituted their main business activity (DQ1.4).

Further analysis showed that the majority of the respondents came from SCs with 2 shareholders (DQ2.1) who were also directors (DQ2.4) of the company, with 47% of the companies having up to 5 employees and 96% having up to 50 (DQ2.5). About 80% had an annual turnover under £2m (DQ2.6).

From the above analysis, it can be seen that the majority of the companies were "small" as defined by the CA 1985.

Before presenting the findings of the survey, it is important to consider the level of understanding of the questionnaire by the respondents. In addition to the general disadvantages associated with postal questionnaires (see 6.4), it should be borne in mind that "...in relation to accounting information it is possible that misunderstandings are prevalent". (Page 1981:50).

Page (1981) in his survey found that relatively few respondents claimed any significant experience in accounting. For example, only 5% of his respondents claimed to have accounting qualifications, whilst 6% and 27% of the respondents claimed to have attended "courses in accounting" and have "book-keeping experience" respectively.

This survey, however, appears to have recorded a relatively high number of respondents claiming to have significant experience in accounting. For example, 21% claimed to have an accounting qualification. A number of conclusions may be drawn from the above differences. For example, the time lag between the two surveys or the sample size of this survey, which is considered "bigger" than "average", could possibly provide some explanations.

It is fair to assume that a high proportion of the respondents with accounting experience could distinguish between the different forms and contents of the accounts and the main alternatives to SC audit. However, some technical questions (e.g. the application of SSAPs to SCs or audit requirement of different categories of SCs) were excluded from the directors' questionnaire as a result of the pilot study which indicated that a number of directors appeared to lack full understanding of these concepts. Furthermore, considering that 38% of the respondents had little or no accounting experience, the accuracy of their answers to some of the questions may be in doubt.

It is worth mentioning that directors' perceptions are possibly more important than precise understanding of all the concepts underlying the questions in this survey.

Finally, the cross-tabulation of answers to the key questions (see 6.6) failed to reject the hypothesis of similar responses from prompt and late respondents. Therefore, there is little evidence that the responses to the questionnaires are unrepresentative of the opinions and characteristics of directors of SCs as a whole.

8.3 Ownership and control of SCs (DQ2.3)

The ownership and control of SCs is of interest when assessing the appropriateness of the current reporting requirements by SCs. For this reason, the sample directors were asked about their shareholdings in their companies. Sixty nine per cent of the respondents (and their families) claimed that they had total control of their companies and held more than 50% of the share capital (i.e. majority control) in 91% of the companies. Accordingly, directors (and their families) were minority shareholders in only 9% of the companies.

It is noteworthy that these findings are similar to those of the survey of annual returns and accounts of SCs, carried out nearly ten years ago by Page (1981), viz:

Table 8.1: Percentages of shareholdings held by directors and their families

% of shareholdings held by directors and their families	% of companies This survey	% of companies Page's survey
0% - 50%	9	6.1*
51% - 75%	4	5.3
76% - 99%	18	10.9*
100%	69	77.7
	100	100.0

(* original percentages are grouped for comparison).

The above comparison indicates that despite changes in the business environment and company law, control of SCs continues to be in the hands of the directors. Furthermore, there are three possible resulting points:

- the current reporting requirement, which is based on the stewardship principle, may not be appropriate for SCs where the majority of directors report to themselves as shareholders;

- although directors may be shareholders, in some cases they are not financially orientated and an element of protection may be required for them; and

- some safeguards are needed for minority shareholders not involved in management.

Furthermore, the directors' survey indicated (DQ2.2) that non-director shareholders were interested in the companies' accounts and their audit. This supports the argument that "...shareholders who are not connected with the management of a company need reassurance that their interests are being properly protected" (APC, 1979:para. 13).

8.4 Advantages and disadvantages of incorporation

Advantages of incorporation (DQ2.7)

Directors were asked the main advantages they derived from running their business as a company rather than as a partnership or as a sole-proprietor.

"Limitation of liability" was considered by the majority (54%) to be the main advantage of incorporation. This is despite the fact that in SCs, directors usually have to provide personal guarantees to secure the company's borrowings. This discounts the argument that "...in many small businesses, the benefits of limited liability have been eroded by the giving of personal guarantees to lending institutions" (APC (1979), para. 33).

Indeed, comparing this survey to that of Page (1981), the importance of "limitation of liability" is higher now (54%) than a decade ago (46%). It is worth noting that Freedman and Godwin (1993) reported that 63.5% of their respondents claimed limited liability was the main reason for incorporating.

The following table provides the main advantages of incorporation as claimed by the sample directors.

Table 8.2: The main advantage of incorporation

	% of respondents	
	This survey	Page's survey
Limitation of liability	54	46
Tax saving	14	16
Ease of transfer of ownership	10	11
Ability to raise finance	9	12
Rights and duties of share-holders and directors are defined	5	6
Other (incl. not answered)	8	9
	100	100

"Tax saving" and "ease of transfer of ownership" were considered by 14% and 10% respectively to be the main advantage of incorporation.

At the time when this survey was carried out, during the deep recession of 1991/92, the majority of companies and in particular SCs had problems in raising finance. This might possibly explain why the "ability to raise finance" received lesser importance (9%) than a decade ago (12%) (Page, 1981).

Disadvantages of incorporation (DQ2.8)

With regard to the main disadvantage of incorporation, 50% of the respondents claimed it was the "need for an audit", followed by "government form filling" (24%) and "disclosure of financial information" (13%). The following table provides the main disadvantages of incorporation as perceived by the directors.

Table 8.3: The main disadvantage of incorporation

	% of respondents	
	This survey	Page's survey
Need for an audit	50	12
Government form filling	24	44
Disclosure of financial information	13	21
Tax problems	9	10
Other (incl. not answered)	4	13
	100	100

Comparison of the above findings with those of Page (1981)'s survey highlights a number of interesting points, which are considered below.

There is a significant increase (from 12% in Page's survey to 50% now) in the percentage of directors who considered the "need for an audit" to be the main disadvantage of incorporation. This might possibly be due to an increase in the costs of an audit as a result of audit regulation (see for example, Freedman and Godwin, 1993). This is borne out by 57% of the respondents who said that "the principal burden of preparing annual accounts is the fee we pay to our professional accountants" (DQ3.24) and also by 50% of the respondents who claimed that "the cost of producing the full annual accounts outweighs the benefits derived from them" (DQ3.24).

Furthermore, this is demonstrated in the parallel auditors' survey where 59% of the respondents claimed that "the regulation of auditors under the Companies Act 1989 has resulted in extra costs to auditors which are passed to their audit clients". It should be pointed out that Freedman and Godwin (1993) reported in their survey that overall 72% of their respondents claimed that the cost of statutory audit was a disadvantage of incorporation.

In Page (1981)'s survey, "government form filling" (44%) had been considered the main disadvantage of incorporation a decade ago. However, since the publication of the "Burden on Business" report in March 1985 by the DTI, which made recommendations for reducing administrative burdens on companies arising from the requirements of company law, there has been a significant reduction in the demands for information from SCs, resulting in less "government form filling" (e.g. reduction in statistical returns, simplifying the collection of PAYE/NIC). This could possibly account for the reduction in the percentage of respondents who claimed that "government form filling" was the main disadvantage of incorporation (see Freedman and Godwin, 1993).

8.5 Users of SC accounts and their accounting information needs

Generally speaking, annual accounts are prepared for shareholders to enable them to evaluate the effectiveness of the stewardship function of company management. In addition to shareholders' use, there are other uses of annual accounts. In this respect, the sample directors were asked to rank in order of importance the main uses of their company's full accounts. The following table summarises the main findings:

Table 8.4: The main uses of SC accounts

	% of respondents	
	This survey	Page's survey
Supporting tax computations	35	26
Providing information to banks (or providers of finance)	28	17
Providing information to management/directors	19	41
Reporting to shareholders	12	7
Providing information to trade creditors	3	1
Other (incl. employees and not answered)	3	8
	100	100

(Note: Throughout this Chapter, where respondents were requested to rank items in order of importance, their responses have been reported on the basis of the number of first ranks accorded by the respondents, see section 6.7).

As can be seen from the above table, "supporting tax computations" (35%) was considered to be the most important use of the annual accounts. This was followed by "providing information to banks (or providers of finance)" (28%) where banks are generally thought to use the accounts as a basis for their lending decisions and as a means of monitoring the continuing security of advances made.

"Providing information to management/directors" (19%) was considered to be the third most important use of accounts. However, in Page (1981)'s survey, providing information to management (41%) had been the most important use of annual accounts. This finding may possibly indicate that the annual accounts are now less used by management than before, reflecting an increasing use of management accounts, which provides more up-to-date information, with the help of accounting computer packages. Furthermore, the discrepancy between these results is probably explained by differences in the size profiles of the sample companies. As indicated earlier (see section 8.1), the sample companies of this survey were "bigger" than "average" in terms of turnover and employment distributions. Another possible explanation (not investigated by this research) may be the increased use of computer packages to produce management accounts over the last decade. In fact 66% of the respondents claimed that their decisions are based on management information rather than the full annual accounts (DQ3.24). This may be due to delay in production of the annual accounts which severely limits their use. Furthermore, statutory accounts do not always give full details of items in the accounts (e.g. details of bank accounts and directors current accounts). This is probably going to get worse now under the reduced disclosure requirements introduced by the DTI (SI 2452) for SCs' shareholders accounts (see section 4.10).

Tax authorities (DQ3.11)

As shown above, the tax authorities were considered to be the most important user of the accounts. Accordingly, it was felt important within the scope of this survey to find out what information in the accounts directors considered to be important for use by the tax authorities. This was based on the belief that as directors are responsible for preparation of the accounts, in theory they could be asked by the Inland Revenue to justify or explain items in the accounts.

The majority (71%) of the sample directors claimed that the Inland Revenue was primarily looking for "profit and loss account items" in the accounts. This was followed by "trading account items" (48%) and "balance sheet items" (44%).

It is worthy of note that an "audit report" (30%) and "auditors' reputation" (18%) were not considered by the sample directors to be very important in the Inland Revenue's detailed examination of their annual accounts.

Banks and other providers of finance (DQ3.10)

As banks and other providers of finance use accounts as a basis for taking lending decisions and as a means of monitoring the continuing security of advances made, it was considered important within the scope of this survey to identify what information in the accounts directors considered important for use by banks and other providers of finance for the purpose of their examination of the accounts.

The majority of the directors claimed that banks were primarily looking for information about "stability" (58%), "liquidity" (54%), "trends of performance" (54%) and "interest coverage by profit" (42%) when they examined their accounts. Other information such as their "growth" (41%) and "gearing" (36%) were also claimed to be important for banks.

It is interesting to note that "audit report" (32%) and "auditors' reputation" (13%) were not considered by the sample directors to be very important when banks examined SC accounts; a finding similar to that of tax authorities.

Employees (DQ3.13)

According to the majority of the sample directors, their employees could not make use of the audited accounts as a tool for wage negotiations or to assess the prospective viability of their company.

These findings support the arguments in the APC (1979)'s discussion paper that in SCs the audited accounts are unlikely to be used by employees as a tool for wage negotiations or to assess prospective viability of their employers' companies.

It is noteworthy that only 17% of the sample directors claimed that they made copies of their audited accounts available to their employees (DQ3.12).

8.6 Usefulness of the accounts

Directors were asked specific questions about how they perceived the usefulness of annual accounts for assessing financial aspects of other companies, making business and management decisions and assessing the creditworthiness of a new business contact. In addition, the sample directors' views of their companies' main competitors, and whether their competitors had ever used their companies' publicly filed information to their companies' disadvantage, were sought.

In response to the perceived usefulness of annual accounts for assessing financial aspects of other companies (DQ3.4), 27% of the respondents said that they did not read other companies' annual accounts. Of the respondents who actually read other companies' full annual accounts, 46% claimed that they were able to assess realistically the "profitability" of other companies from their accounts. This was followed by their assessment of "capacity to survive" (42%), "financial trends" (29%) and "investment policy" (25%).

With regard to the perceived usefulness of annual accounts for business decisions (DQ3.5), a summary of responses ranked in order of importance is presented below:

Table 8.5: Importance of particular information in annual accounts for business decisions

	% of respondents
Profit before tax	28
Net current assets	25
Turnover (if stated)	15
Cash/fund statement	7
Gross profit	5
Total assets	5
Audit report	4
Other (incl. not answered)	11
	100

As can be seen from the above table, "profit before tax" was considered by 28% of the respondents to be the most important financial factor for business decision contained in the published annual accounts, followed by "net current assets" (25%) and "turnover (if stated)" (15%).

It should be pointed out that as some SCs file abbreviated accounts, which do not include a profit and loss account, it appears that "profit before tax" and "turnover" may not be regularly used for business decisions, unless full accounts of such companies are obtained.

It is interesting to note that "audit report" was considered by 4% of the respondents to be the least important information contained in the annual accounts for making business decisions. It is probably fair to say that despite the least importance accorded to it by the respondents, "audit report" usually provides very important qualitative information about a company (e.g. whether it is a going concern or whether the accounts give a true and fair view, etc.). The reason why "audit report" was not considered to be important may be due to difficulties in interpreting and understanding its contents. It is worth noting that the APB has revised the wording of the audit report with a view to making it clearer and more understandable. The new detailed audit report came into effect for accounting periods ended on or after 30 September 1993.

Another important question raised was to ascertain the usefulness of annual accounts for <u>management decisions</u> (DQ3.6). A large number of respondents (29%) claimed that their decisions about dividends and directors' remuneration were directly influenced by annual accounts (see also Carsberg et al, 1985:42). One possible explanation for use of annual accounts for making decisions about how much dividends to pay is provided by the CA 1981, which requires that dividends may be paid only out of "distributable profits", determined in accordance with the annual accounts.

The following table provides a summary of responses ranked in order of importance of the perceived usefulness of annual accounts for making the following management decisions.

Table 8.6: Importance of annual accounts for management decisions

	% of respondents
Dividends and directors' remuneration	29
Cash management	22
Borrowing	14
Pricing	11
Capital expenditure	8
Staff pay and conditions	6
Other (incl. not answered)	10
	100

The other management decision, which respondents claimed was influenced by annual accounts, was about "cash management". However, the respondents accorded less importance to the perceived usefulness of annual accounts for making decisions about "borrowing", "pricing", "capital expenditure" and "staff pay and conditions". It is worth noting that Carsberg et al (1985:42) have also found that "Pricing decisions were not influenced much by annual accounts..."

With reference to the perceived usefulness of annual accounts for making credit assessment (DQ3.2), the majority of respondents (64%) claimed that they use "personal contacts" to assess the creditworthiness of a new business contact. Similarly 60% and 59% of the respondents claimed that they use "trade references" and "bank references" respectively.

It appears that these findings are consistent with the argument that "...suppliers wishing to investigate the creditworthiness of the small firm are more likely to rely on trade references and personal contacts". (APC, 1979:para. 23).

Other main sources used by the respondents for making credit assessment included the use of credit reference agencies and requesting to see a new business contact's <u>full</u> accounts.

It is worth pointing out that only 4% of the respondents claimed that they use abbreviated accounts for this purpose. Indeed the author is aware of examples where credit lines were withdrawn following a review of abbreviated accounts and were only restored when the customer sent full accounts which showed that their reserves were depleted because of payments of large dividends rather than losses.

In addition to the above sources, a <u>search</u> (DQ3.3) may be carried out directly or through advisers in order to obtain publicly filed information about a business contact company. Accordingly, the sample directors were asked how many times in the last year they had had cause to search in this regard.

Forty seven per cent of the respondents claimed that they had had cause to search the publicly filed information during the last year. The full details of responses are provided in the following table.

<u>Table 8.7: Number of searches undertaken during the last year</u>

	<u>% of respondents</u>
Nil	53
1	18
2	13
3	4
4	1
5	3
more than 5	8
	100

The above table shows that a large proportion of respondents searched the publicly filed information about a business contact company.

It is often argued that some of the publicly filed information is undesirable because it provides information to the competitors and as such is considered intrusive into the owners' private affairs, particularly in respect of SCs. In order to investigate this, the sample company directors were asked who were their main competitors (DQ3.8). The highest proportion of respondents (44%) considered other "small local businesses" as their main competitors. Accordingly, it is arguable that disclosure of information to other small local businesses could not be used to their disadvantage, as they are all small, and they can all file abbreviated accounts which do not show their trading and profit and loss accounts.

It is worth mentioning that "large local businesses" (35%) and "large national businesses" (32%) taken together were considered to be the main competitors of small businesses. It would appear that disclosure of financial information by SCs is undesirable for their competitiveness. This might be one of the reasons that the CA 1981 allowed SCs to file abbreviated accounts which do not show their trading and profit and loss accounts. (It should be pointed out that the total of the above percentages does not add up to 100%, because some respondents had identified more than one main competitor).

Respondents were further asked whether their competitors had ever used their publicly filed information to their company's disadvantage (DQ3.9). In response, only 6 (6%) of the directors claimed that was the case. However, while five of the respondents did not specify how that happened, only one respondent claimed that their business contact used such information to their company's disadvantage.

8.7 Form and content of SC accounts

The main aim of this part of the survey was to investigate whether or not the present form and content of SC accounts should be further simplified. As already explained, the CA 1985 requires that all companies prepare full statutory accounts for their members and SCs (as defined by the Act) may file abbreviated accounts with the Registrar of Companies. In 1992, the DTI introduced new regulations (see SI 1992 No. 2452) aimed at reducing the detailed disclosure requirements made in the accounts for members of SCs. It is worth mentioning that earlier, the DTI (1985b) had proposed that abbreviated accounts only should be prepared by all "owner-managed" SCs (and/or other categories of SCs), because the requirement to prepare full accounts had been deemed to be expensive and unnecessary for such companies. The ICAEW (1985:2) also recommended that "...only one set of statements be prepared for both the shareholders and filing" because they argued that it "...will reduce the burden of accounting requirements on small companies and also the associated audit effort". (ICAEW, 1985:2).

In addition to the above arguments, the LSCA (1992:8) also argued that "...the distinction between "full" and "abbreviated" accounts and the occasions when the latter may be used are not particularly well understood by small companies...". This survey sought the views of the sample directors about some of the above and other related issues in order to ascertain the extent of support for the above proposals. As indicated in section 8.2, some of the respondents, for example those with an accounting qualification, appeared to have little difficulty in distinguishing between the different forms and contents of SC accounts. However, as 38% of the respondents had little or no accounting experience, it is doubtful whether their answers to the issues raised in this section were accurate. Nevertheless, it is the perceptions held by the directors that are considered to be important to this survey.

With reference to the main proposals put forward by various bodies, the sample directors were asked about their views on the preparation of only one set of accounts for both shareholders and public filing, and what they considered to be their benefits and contents.

Interestingly, the majority (77%) of the directors said that only one set of accounts should be prepared for both shareholders of SCs and public filing (DQ3.27). With regard to the first perceived benefit of "one set of accounts", 47% of the directors claimed that it would "improve the use of publicly filed information". One possible explanation for this perception might be the lack of support for abbreviated accounts among directors. For example, the majority of directors did not consider that abbreviated accounts were useful for business (71%) or investment (79%) decisions or for public (82%) information (DQ3.26).

In considering the second benefit, 70% of respondents claimed that preparation of "one set of accounts" would "reduce the burden of accounting requirements on small companies". In this regard, it is interesting to note that a large number of respondents claimed that preparation of full (DQ3.18) and abbreviated (DQ3.26) accounts was "a waste of time and money". They also claimed that full accounts were neither intrusive into the owner's private affairs nor useful for shareholders.

As already pointed out, for a SC choosing to prepare abbreviated accounts for filing, it would incur additional costs estimated at between £100 and £250. The estimates are based on the size of the accountancy practice and its geographical location (see DTI, 1995:50). Replacing full and abbreviated accounts with "one set of accounts" could possibly save SCs the above additional compliance costs.

In response to the third perceived benefit, 56% of respondents claimed that "one set of accounts" would "reduce the associated audit effort". For example, auditors need not give two sets of reports - one for full accounts and one for abbreviated accounts.

With respect to the possible content of "one set of accounts", the majority of directors indicated that it should include a shortened directors' report, a shortened profit and loss account, a full balance sheet and relevant notes to the accounts but no cash/funds statement (DQ3.29).

It is worth noting that the ICAEW (1985), when it proposed the preparation of "one set of accounts" to replace full and abbreviated accounts, recommended the inclusion of a company's sales and profit performance in the abbreviated (shortened) profit and loss account. It is interesting to note that the majority of the sample directors considered that "profit before tax" (74%) and "turnover (sales)" (72%) should be publicly disclosed in SC accounts, despite the fact that SCs are exempt from disclosing their profit and loss account in their published abbreviated accounts on the grounds that it could possibly be used by their competitors to the disadvantage of the SCs.

From the above findings, it is possible to suggest that "one set of accounts" may benefit from the inclusion of the above information.

It should be pointed out that in 1992, the LSCA (1992:8) proposed that "...an "annual accounting return" should be developed for filing purposes and which also could be used as the basis for meeting the minimum requirements for accounts for members". More recently, the DTI (1995) in considering simplification of the accounts of SCs, has proposed for discussion the preparation of a standard format of accounts containing five sections, namely: a reduced balance sheet with relevant notes for filing at Companies House (section 1), additional breakdown of items in the balance sheet and notes (section 2), a profit and loss account (section 3), a directors' report (section 4) and supporting figures needed by the Inland Revenue (section 5), from which relevant section(s) could be extracted to meet various users' needs. Generally speaking this proposal is similar to the proposal of "one set of accounts" considered in this research. However, the DTI(1995)'s proposal requires that different section(s) of the accounts be sent to different users based on existing requirements (e.g. section 1 to be sent to Companies House, sections 1 to 4 to shareholders and sections 1 to 5 to the Inland Revenue), whereas, in this research, "one set of accounts" was intended to be used for all purposes by all users.

From the above discussion, one possible trend is discernible and that is the need to simplify the form and content of SC accounts.

8.8 The accountants' role in SCs

The SC auditors/accountants often provide a range of financial services (e.g. preparation of accounts, taxation, audit, etc.) to their SC clients. In order to ascertain directors' views about the accountants' role in SCs, the directors were asked who prepared their company's annual accounts and the importance of services provided by their accountants. Furthermore, they were asked whether they were satisfied with the services provided and whether they had changed their auditors recently.

In response, the majority (53%) of the directors claimed that their accounts were prepared by the company's auditors. Furthermore, 27% of the respondents claimed that accountants employed by the company, who were not directors, prepared their accounts. The remaining (20%) of the directors said that they prepared their companies' accounts themselves. (DQ3.20).

With reference to the range of services provided by their accountants, the sample directors were asked to rank them in order of importance. The highest proportion (34%) of the directors considered that "tax advice" was the most important service.

The following table provides a summary of responses by the sample directors.

<u>Table 8.8: Importance of services provided by the accountants</u>

	% of respondents
Tax advice	34
Preparation of accounts	31
Audit of accounts	23
Business advice	8
Company secretarial services	3
Other	1
	100

As can be seen from the table, "preparation of accounts" (31%) was ranked more important than "audit of accounts" (23%). These findings are similar to a number of surveys (Carsberg et al, 1985 and Humphrey and Turley, 1986) where traditional accountancy services were ranked highest.

Other services such as "business advice" (8%) and "company secretarial services" (3%) were not considered important for SCs.

In response to the question (DQ3.21) as to whether directors were satisfied with the services provided by their accountants, a large majority (84%) responded positively. Furthermore, only 10% of the directors indicated that they had changed their auditors recently (DQ3.22). Some of the reasons cited for the changes were auditors' fees being too high, or auditors were too small to cope, or the previous auditor had decided not to become a registered auditor.

DIRECTORS' ATTITUDES TO SC AUDIT ISSUES

A number of studies (for example, see Humphrey and Turley, 1986) have argued that directors (and in particular owner-managers) have different perceptions about the role of audit in their companies. These perceptions may aid the understanding of the current SC audit debate from their point of view. In this regard, the sample directors were, first of all, asked questions about the audit function and what they considered to be the main benefits of audit to their companies. Secondly, an attempt was made to ascertain the extent and reasons for audit qualifications in their companies.

Finally, the sample directors' views about a possible change of audit requirement for SCs were sought and its possible effects were ascertained.

8.9 Audit function and audit benefits (DQ4.3 and DQ4.2)

In response to the question as to what they considered the most important function of the audit, 29% of the respondents claimed the most important function was to report to themselves as directors (DQ4.3). The same percentage also claimed that it was to report to shareholders. A summary of the responses is provided in the following table.

Table 8.9: Directors' opinions about the most important function of the audit

	% of respondents
Report to directors	29
Report to shareholders	29
Report to creditors	19
To detect fraud	13
Other	10
	100

According to Humphrey and Turley (1986), fraud is often quoted as an area of misunderstanding regarding the auditors' responsibilities. It is interesting to note that only a small minority of the respondents (13%) claimed that the most important function of the audit was "to detect fraud". This may, according to Humphrey and Turley (1986:34), be due to "...size and close control in many small companies, [where] the possibility of fraud is not a major concern of the directors".

The above findings may indicate that there are a wide variety of opinions among directors about the audit function. This variety of opinion may have some influence on their views about SC audit issues and may possibly indicate a lack of understanding of the auditor's role.

With reference to the main benefits that SCs may obtain from the annual audit, 30% of the directors said that "to satisfy the bank's lending requirements" was the main benefit (DQ4.2). Another important benefit the directors claimed was in the area of taxation. The following table provides a summary of their responses about audit benefits.

Table 8.10: Directors' opinions about the main benefit of annual audit

	% of respondents
To satisfy the bank's lending requirements	30
Easier acceptance of tax computations	28
Assurance of efficient financial management	20
No significant advantage	20
Other	2
	100

It is interesting to note that 20% of the directors claimed that there was "no significant advantage" to their companies from having an annual audit.

8.10 Audit report qualification (DQ3.23)

In order to investigate the extent and reasons for audit report qualification for SCs, the directors' views on these were ascertained by asking them whether their latest published accounts had been qualified by their auditors and if so, to indicate the reason for its qualification.

In response, 77% of the directors claimed their companies had received a "clean" audit report on their latest published annual accounts. With respect to the remaining 23% of the sample companies, which had had their latest published annual accounts qualified, the following table provides the reasons for their qualifications.

Table 8.11: Reasons for audit report qualifications

	% of respondents
Non-going concern	7
Non-compliance with the accounting standards	4
Non-compliance with the Companies Act	2
Limitation of audit scope due to absence of internal controls	2
Other	1
Do not know	7
	23

As can be seen from the table, 7% of the sample companies' audit reports were claimed to be qualified because their auditors were unable to assess whether they were a "going concern". Considering that the survey was carried out during the recession of 1992/93, this finding may be understandable.

It is worth noting that only 2% of the sample companies' audit reports were claimed to be qualified because of a limitation of audit scope due to absence of internal controls. If the general argument that "lack of internal control" is the major problem in auditing SCs (see for example, Humphrey and Turley (1986) and the auditors' survey in Chapter 9) then this rather low percentage (2%) may have been as a result of the withdrawal of "Example 6" audit report in 1989 and/or the APC (1991)'s recommendations (see section 4.16).

8.11 Directors' attitudes to a possible change of audit requirement for SCs (DQ4.4)

The sample directors were asked to indicate whether, in their opinion, the statutory audit requirement for SCs should be retained or abolished subject to a number of given possibilities. Furthermore, they were offered the possibility of replacing audit with a statutory review. Other possibilities, a compilation report for example, were not offered as the directors were not generally conversant with these alternatives (see also pilot study in section 6.4 and section 8.2). However, a compilation report alternative was considered in the case of the auditors' survey (see Chapter 9). Their responses are grouped under three broad headings, namely: "For audit", "Against audit" and "For review". These are presented in the following table.

Table 8.12: Directors' attitudes to change of the audit requirement for SCs

		% of respondents
For audit		
- there should be no change in the current audit requirement and standards for SCs		12
- SCs should continue to be audited but separate auditing standards should be developed		21
		33
Against audit		
The audit requirement for SCs should be abolished:		
- subject to protection of minority shareholders	18	
- only if all members are directors and subject to annual confirmation in general meeting by all members	17	
- without any condition/reservation	16	
		51
For review		
SCs should be allowed to opt for a statutory review instead of an audit		16
		100

As can be seen from the table, the majority of the sample directors (51%) indicated that they were in favour of the abolition of the SC audit requirement subject to a number of possibilities. One possible explanation for favouring abolition of the SC audit requirement may be the increase in audit fee as a result of audit regulation introduced by the CA 1989. Indeed, as Freedman and Godwin (1993) have observed, the strength of feeling among companies against the mandatory audit has worsened since the tightening of auditor regulation under the CA 1989.

Of the 33% respondents who favoured retention of the SC audit requirement, only 12% favoured retention in its present form.

Interestingly, 16% of the respondents who opted for a statutory review instead of an audit were mainly those with accounting qualifications or experience. It is worth mentioning that the majority of the sample directors (56%) claimed that substitution of a statutory review for an audit would create confusion, despite the fact that less than half the total respondents claimed this would reduce the overall costs and provide almost the same assurances as an audit (DQ4.5).

This finding should be treated with caution as the majority of the directors lacked accounting qualifications or experience which might be considered necessary to assist them to distinguish between audit and review. In this regard, it is worth noting that Humphrey and Turley (1986:31), in their survey, observed that owner-managers' "...knowledge of the nature of the audit arose mainly from the queries that the auditor raised".

Finally, to ascertain the importance attached to audit by the sample directors, they were asked whether they would still consider having a (voluntary) audit for any of the reasons given in the following table, if the statutory requirement to have an annual audit of their company's accounts was removed.

Table 8.13: Directors' actions if statutory audit requirement was removed

		% of respondents
Continue to have a (voluntary) audit mainly for:		
- shareholders	9	
- external users (e.g. the bank)	26	
- efficient running of the company	21	
	--	56
Choose not to have a (voluntary) audit but retain a firm of accountants for other purposes		37
Choose not to employ professional accountants at all		7

		100
		===

As can be seen from the table, the majority (56%) indicated they would continue to have an audit, mainly for the benefit of shareholders, external users (e.g. banks) and efficient running of their companies. Interestingly, 26% of the respondents cited external users as the main category for which they would continue to have an audit. This finding is consistent with the directors' views on perceived benefits of the audit (see section 8.9).

It is interesting to note that 37% of the respondents would choose not to have a (voluntary) audit but retain a firm of accountants for other purposes. This may indicate that at least some of the envisaged savings on audit fees might be used by SCs in other services provided by professional accountants. Only a minority of the respondents would choose not to employ professional accountants at all if the statutory audit requirement for SCs was removed.

8.12 Summary and conclusion

A number of broad conclusions may be drawn from the survey of directors. First and foremost, the ownership and control of SCs are highly concentrated in the hands of directors and their families.

In considering the advantages and disadvantages of incorporation, "limitation of liability" was considered the main advantage derived from incorporation, while the "need for an audit" was the main disadvantage.

With reference to the main uses of published annual accounts, "supporting tax computation" was considered by the highest proportion of the sample directors to be the most important use of annual accounts. It is interesting to note that low priority was given to the use made by the companies' directors, contrary to earlier findings (Page, 1981).

It emerged from the survey that the directors perceived the usefulness of the annual accounts in a number of ways, for example, for making business decisions or to assess the creditworthiness of a new business contact.

With regard to making business decisions, the directors considered profit before tax, net current assets and turnover (if stated) the most important financial factors.

In assessing the creditworthiness of a new business contact, the majority of directors said they used personal contacts, bank and trade references. In this case, a low priority was given to the use of annual accounts.

With respect to disclosure of certain information in the accounts, the majority of directors said that "profit before tax" and "turnover (sales)" should be publicly disclosed in accounts.

In considering simplification of the form and content of SC accounts, the overwhelming majority of directors supported the view that only "one set of accounts" should be prepared for both shareholders of SCs and filing with the Registrar of Companies. With reference to the perceived benefits of this simplified form of accounts, the majority of sample directors claimed it would reduce the burden of accounting requirements on SCs and the associated audit effort.

The majority of directors were satisfied with the services they received from their professional accountants. Tax advice was considered the most important service provided, followed by preparation of accounts and the audit.

There was a wide variety of opinion among the sample directors about the audit function, which may possibly indicate a lack of understanding of the auditor's role. However, "to satisfy the bank's lending requirements" and for "easier acceptance of tax computations" were considered the main benefits of annual audit.

The majority of companies in the survey, according to their directors, had unqualified audit reports for their latest published annual accounts.

Finally, with reference to possible changes in the audit requirement of SCs, the majority of directors claimed to support abolition of the SC audit, perhaps among other reasons, because of the increased audit fee resulting from introduction of the audit regulation by the CA 1989. Despite this, the majority of directors indicated that they would continue to have a (voluntary) audit mainly for external users (e.g. banks) and efficient running of their companies.

The next Chapter considers the results of the auditors' survey with particular attention to some of the issues raised in this survey.

SUPPLEMENT TO CHAPTER 8

FULL LIST OF RESPONSES BY THE SAMPLE DIRECTORS & SHAREHOLDERS OF PRIVATE SCs TO THE QUESTIONNAIRE IN APPENDIX 2

Table No.

SECTION 1: Personal information

DQ1.1 Directors' status

Are you (or were you during the last three years)

	% of respondents
i) a director of a small company	28
ii) a shareholder in a small company	1
iii) both of these	77

	100
	===

DQ1.2: Directors' age group

Your age group:

	% of respondents
i) under 30	10
ii) 30 - 45	48
iii) 46 - 60	35
iv) above 60	7

	100
	===

DQ1.3: Directors' main area of expertise

Which is your main area of expertise

	% of respondents
i) technical (e.g. engineering, manufacturing)	19
ii) commercial (e.g. buying and selling)	36
iii) financial	25
iv) other professional (e.g. law)	8
v) other	12

	100
	===

Table No.

DQ1.4: Directors' main business activity

Does your work within the company constitute your main business activity:

	% of respondents
i) Yes	71
ii) No	29

	100
	===

Q1.5: Directors' accounting experience

What level of accounting experience do you have:

	% of respondents
i) accountancy qualification	21
ii) courses in accounting	16
iii) book-keeping experience	25
iv) little or no accounting experience	38

	100
	===

SECTION 2: Your company

DQ2.1: Directors' company - No. of shareholders

How many shareholders are there in your company

	% of SCs
i) 1 - 2	54
ii) 3 - 4	34
iii) 5 - 6	5
iv) 7 - 10	2
v) over 10	5

	100
	===

Table No.

DQ2.2: Directors' company - No. of non-director shareholders

Do you have any shareholders who are not directors of your company

	% of respondents
i) Yes	41
ii) No	59

	100
	===

If yes, do you consider that they take an interest in the accounts and audit of your company

i) Yes	58
ii) No	42

DQ2.3: Directors' company - % of shareholdings held by directors and their families

What percentage of your company's share capital is held by the directors and their families

% of shareholdings held by directors and their families	% of SCs
i) 0%	1
ii) 1 - 25%	4
iii) 26 - 50%	4
iv) 51 - 75%	4
v) 76 - 99%	18
vi) 100%	69

	100
	===

DQ2.4: Directors' company - No. of directors

How many directors are there in your company

	% of SCs
i) 1	7
ii) 2	49
iii) 3	23
iv) 4	15
v) 5 and more	6

	100
	===

Table No.

DQ2.5: Directors' company - No. of employees

Number of employees in your company

		% of SCs
i)	0 - 5	47
ii)	6 - 10	16
iii)	11 - 20	25
iv)	21 - 50	8
v)	51 - 100	3
vi)	over 100	1

		100
		===

DQ2.6: Directors' company - annual turnover

Your company turnover

		% of SCs
i)	£1 - £0.25m	34
ii)	£0.25m - £0.5m	12
iii)	£0.5m - £1m	24
iv)	£1m - £2m	10
v)	£2m - £5m	12
vi)	over £5m	8

		100
		===

DQ2.7: The main advantage of incorporation

What is the main advantage of running your business as a company rather than as a partnership or as an individual

		% of respondents	Page's survey
i)	limitation of liability	54	46
ii)	tax saving	14	16
iii)	ease of transfer of ownership	10	11
iv)	ability to raise finance	9	12
v)	rights and duties of share-holders and directors are defined	5	6
vi)	other (incl. not answered)	8	9
		---	---
		100	100
		===	===

Table No.

DQ2.8: The main disadvantage of incorporation

What is the main disadvantage of running your business as a company?

	% of respondents	Page's survey
i) need for an audit	50	12
ii) government form filling	24	44
iii) disclosure of financial information	13	21
iv) tax problems	9	10
v) other (incl. not answered)	4	13
	100	100

SECTION 3: Small company accounts

DQ3.1: The main uses of SC accounts

Please rank in order of importance the following uses of your company's full annual accounts

	% of respondents	Page's survey
i) supporting tax computations	35	26
ii) providing information to banks (or providers of finance)	28	17
iii) providing information to management/ directors	19	41
iv) reporting to shareholders	12	7
v) providing information to trade creditors	3	1
vi) other (incl. employees and not answered)	3	8
	100	100

Table No.

DQ3.2: Usefulness of annual accounts for making credit assessment

How do you assess the creditworthiness of a new business contact?

		% of respondents
i)	personal contacts	64
ii)	trade references	60
iii)	bank references	59
iv)	credit reference agencies	31
v)	ask to see their full accounts	20
vi)	ask to see their abbreviated accounts	4
vii)	other (incl. not answered)	5

DQ3.3: Public Search

How many times in the last year have you had cause to search either directly or through advisers, the publicly filed information about a business contact company?

		% of respondents
i)	Nil	53
ii)	1	18
iii)	2	13
iv)	3	4
v)	4	1
vi)	5	3
vii)	more than 5	8
		100

DQ3.4: Usefulness of annual accounts for assessing financial aspects of other companies

Which of the following financial aspects of other companies are you able to assess realistically from their published annual accounts?

		% of respondents
i)	profitability	46
ii)	capacity to survive	42
iii)	financial trends	29
iv)	investment policy	25
v)	none of the above	12
vi)	do not read other companies' reports	27

Table No.

DQ3.5: Usefulness of annual accounts for business decisions

Please rank in order of importance for business decisions the following information contained in the published annual accounts of other private companies

		% of respondents
i)	profit before tax	28
ii)	net current assets	25
iii)	turnover (if stated)	15
iv)	cash/fund statement	7
v)	gross profit	5
vi)	total assets	5
vii)	audit report	4
viii)	other (incl. not answered)	11
		100

DQ3.6: Usefulness of annual accounts for management decisions

Please rank in order of importance the extent to which the annual accounts influence the following management decisions of your company

		% of respondents
i)	dividends and directors' remuneration	29
ii)	cash management	22
iii)	borrowing	14
iv)	pricing	11
v)	capital expenditure	8
vi)	staff pay and conditions	6
vii)	other (incl. not answered)	10
		100

DQ3.7: Usefulness of annual accounts for investment decisions

If you personally own shares in one or more publicly quoted companies, do you find their accounts useful in making investment decisions

		% of respondents
i)	Yes	15
ii)	No	44
iii)	No investment in quoted companies	41
		100

Table No.

DQ3.8: SCs main competitors

Who are your company's main competitors?

	% of respondents
i) small local businesses	44
ii) large local businesses	35
iii) large national businesses	32
iv) other	16

DQ3.9: SCs competitors: use of publicly filed information

To your knowledge has any competitor ever used the publicly filed information concerning your company to your company's disadvantage?

	% of respondents
i) Yes	6
ii) No	94
	100

DQ3.10: Directors' opinions about the bank's information needs

If the bank examines your company's annual accounts, what do you consider it is primarily looking for?

	% of respondents
i) stability	58
ii) liquidity	54
iii) trends of performance	54
iv) interest coverage by profit	42
v) growth	41
vi) gearing	36
vii) audit report	32
viii) auditors' reputation	13

Table No.

DQ3.11: Directors' opinions about the Inland Revenue's information needs

If the Inland Revenue examine your company's annual accounts, what do you consider they are primarily looking for?

	% of respondents
i) profit and loss account items	71
ii) trading account items	48
iii) balance sheet items	44
iv) audit report	30
v) auditors' reputation	18
vi) other	8

DQ3.12: Availability of SC accounts to their employees

Do you make copies of your audited accounts available to your employees?

	% of respondents
i) Yes	17
ii) No	83
	100

DQ3.13: Directors' opinions about the use of the audited accounts by their employees

Do you think your employees make any use of the audited accounts:

	% of respondents Yes	No	Not answered
i) as a tool for wage negotiations	6	81	13
ii) to assess the prospective viability of their employer's company	21	65	14

DQ3.14: Directors' opinions about the level of disclosure in modified accounts

In general, do you feel small companies should disclose in their modified accounts

	% of respondents
i) about the same information as at present	60
ii) less information	30
iii) more information	10
	100

Table No.

DQ3.15: Directors' opinions about the level of disclosure in full accounts

In general, do you feel small companies should disclose in their full accounts

	% of respondents
i) about the same information as at present	52
ii) less information	42
iii) more information	6
	100

DQ3.16: Filing full accounts instead of modified accounts

Do you file full accounts with the Registrar of Companies even when you are entitled to file modified accounts?

	% of respondents
i) Yes	36
ii) No	64
	100

DQ3.17: Directors' opinions about the extent of disclosure of some specific items

In your opinion, which of the following figures should be publicly disclosed in small company accounts?

	% of respondents
i) profit before tax	74
ii) turnover (sales)	72
iii) value of stock	44
iv) loans from directors	43
v) total directors' emoluments	35
vi) details of directors' emoluments	18

DQ3.18: Directors' opinions about full accounts

On the whole, are full accounts for the small company

	% of respondents
i) a waste of time and money	57
ii) useful for shareholders	36
iii) intrusive into the owner's private affairs	22

Table No.

DQ3.19: Services provided by SC accountants

Please rank in order of importance the services provided to your company by its professional accountants

		% of respondents
i)	tax advice	34
ii)	preparation of accounts	31
iii)	audit of accounts	23
iv)	business advice	8
v)	company secretarial services	3
vi)	other	1
		100

DQ3.20: Who prepares SCs' annual accounts

Who actually prepares your company's annual accounts?

		% of respondents
i)	company's auditors	53
ii)	accountants employed by the company other than a director	27
iii)	directors	20
		100

DQ3.21: Directors' opinions about their accountants' services

Are you satisfied with the services you receive from your professional accountants?

		% of respondents
i)	Yes	84
ii)	No	16
		100

DQ3.22: Change of auditors

Have you recently changed your auditors?

		% of respondents
i)	Yes	10
ii)	No	90
		100

Table No.

DQ3.23: Qualified audit reports and their reasons

Were your latest published accounts qualified by your auditors

	% of respondents
i) No	77
ii) Yes	23
	100

If qualified, was it because of:

i) non-going concern	7
ii) non-compliance with the accounting standards	4
iii) non-compliance with the Companies Act	2
iv) limitation of audit scope due to absence of internal controls	2
v) other	1
vi) do not know	7
	23

DQ3.24: Directors' opinions about general questions

Which of the following statements do you agree with

	% of respondents
i) the cost of producing the full annual accounts outweighs the benefits derived from them	50
ii) accounts should be produced and filed sooner after the year end	39
iii) decisions are based on our own management information rather than the full annual accounts	66
iv) the principal burden of preparing annual accounts is the fee we pay to our professional accountants	57
v) the accounting profession should continue to attempt to make accounts more useful to users, even if the cost of preparing the information is higher	30

Table No.

DQ3.25: Directors' opinions about SCs' full accounts as compared with large companies full accounts

Do you accept that small companies should be required to prepare full accounts for the shareholders containing almost the same information as the accounts of large companies?

	% of respondents
i) Yes	19
ii) No	81
	100

DQ3.26: Directors' opinions about modified accounts

Which of the following statements do you agree with

The modified accounts of SCs are:	% of respondents
i) a waste of time and money	49
ii) useful for business decisions	29
iii) useful for investment decisions	21
iv) useful for the public	18
v) none of the above	11

DQ3.27: Directors' opinions about "only one set of accounts"

Do you consider only one set of accounts should be prepared both for the shareholders of small companies and for filing?

	% of respondents
i) Yes	77
ii) No	23
	100

Table No.

DQ3.28: Directors' opinions about the effects of preparing "only one set of accounts"

Do you consider if only one set of accounts is prepared both for the shareholders and for filing then it will:

	% of respondents Yes	No	Not answered
i) improve the use of publicly filed information	44	40	16
ii) reduce the burden of accounting requirements on SCs	70	22	8
iii) reduce the associated audit effort	56	25	19

DQ3.29: Directors' opinions about the content of "only one set of accounts"

If only one set of accounts is prepared both for the shareholders and for filing, which of the following items should be included:

	% of respondents in full or shortened
i) directors' report	
ii) balance sheet	
iii) profit and loss account	(See 8.7)
iv) cash/fund statement	
v) notes to the accounts	
vi) other, please specify...	

Table No.

SECTION 4: Small company audit

DQ4.1: The effects of SC audit abolition (e.g. voluntary audit)

If the requirement to have an annual audit of your company's accounts was removed, would you:

		% of respondents
i) continue to have an audit mainly for:		
- the shareholders	9	
- the external users (e.g. the bank)	26	
- efficient running of the company	21	
	--	
		56
ii) choose not to have an audit but retain a firm of accountants for other purposes		37
iii) choose not to employ professional accountants at all		7

		100
		===

DQ4.2: Directors' opinions about the main benefit of annual audit to SCs

What is the main benefit small companies obtain from the annual audit?

	% of respondents
i) to satisfy the bank's lending requirements	30
ii) easier acceptance of tax computations	28
iii) assurance of efficient financial management	20
iv) no significant advantage	20
v) other	2

	100
	===

Table No.

DQ4.3: Directors' opinions about the most important function of the audit

What is the most important function of the audit

	% of respondents
i) report to directors	29
ii) report to shareholders	29
iii) report to creditors	19
iv) to detect frauds	13
v) other	10
	100

DQ4.4: Directors' opinions about the change of the audit requirement for SCs

Which one of the following statements do you agree with most strongly?

(See 8.11)

DQ4.5: Directors' opinions about the effects of replacement of audit with a statutory review

Do you think the substitution of a statutory review in place of an audit will:

	% of respondents		
	Yes	No	Not answered
i) create confusion over the nature and the scope of a review	56	32	12
ii) reduce the overall costs	45	41	14
iii) provide almost the same assurances as an audit	47	33	20

CHAPTER 9

SURVEY OF AUDITORS

9.1 Introduction

This Chapter considers the primary findings of the auditors' survey. The main purpose of the survey was to ascertain the views of SC auditors about certain SCFR issues.

This survey examined a number of important issues raised in the survey of directors, namely: ownership and control of SCs, advantages and disadvantages of incorporation, the main users of SC accounts and the form and content of SC accounts.

In addition, the survey ascertained the experts' (auditors') views on a number of technical issues such as the definition of a SC, the application of accounting standards and the CA requirements for SCs.

Furthermore, the survey paid particular attention to the experts' views about certain SC audit issues, particularly the main benefits to SCs of an annual audit, the effect of audit regulation, the main difficulties in auditing SCs and the effects of the withdrawal of the old "example 6" audit report on auditors' reporting.

Finally, the sample auditors' attitudes to a possible change of audit requirement for different categories of SCs and its possible effects were sought.

With these in mind, questionnaires were sent to a sample of 375 auditors, randomly selected from the LSCA's known Practitioner Members List in November 1992. Section 6.3 provides a detailed analysis of the auditors' sample selection.

One hundred and fifty three analysable responses were received (a response rate of 40.8%) which was considered satisfactory for this type of survey (see 6.5). The "% of respondents" in this Chapter refers to the percentages of 153 auditors who responded. The survey was sponsored by the CUBS and supported by the LSCA.

The major results of the auditors' survey are provided in the body of this Chapter, while others are cross-referenced to the tables (summarising the auditors' responses) in the Supplement to this Chapter. It should be noted that for ease of referencing, the same style of referencing as in the directors' survey has been adopted here.

Again, where appropriate, the findings of this survey have been compared with Page (1981)'s results in order to ascertain the extent of changes in auditors' attitudes in respect of SCFR issues over the last decade.

Chapter 10 provides a cross-analysis of the primary findings and testing of research hypotheses, which provide some assurances about the consistency of these results. The major findings of this survey and the directors' survey are compared and reported in Chapter 11.

As indicated in section 6.2, the views of the auditors were considered vital for this research, primarily because of their technical knowledge in this field and secondly, due to their expressed interest and participation in the SCFR debate. However, against this background, it should be borne in mind, as noted by Page (1981:70), that:

> "...the views of professional accountants should be viewed with caution since accountants may have a vested interest in the continuation of reporting requirements which entail the employment of accountants and auditors".

9.2 Respondents

The majority of respondents claimed to be sole practitioners and partners in small local firms of accountants with up to 5 partners (AQ2.1 and AQ2.2) and 10 professional staff (excluding partners) (AQ2.3).

It should be borne in mind that comparison of the auditors' sample with the general population and similar studies indicates that the sample auditors were "smaller" than "average" in terms of number of partners and employment distributions (see 6.3). Nevertheless, these should be viewed with caution.

The respondents were mainly aged between 30 and 60 years old (AQ1.2), working for their current practices (AQ1.5) and had been members of a professional accountancy body (AQ1.4) for more than 10 years, indicating that they should have a reasonable amount of experience in their profession. For further statistics about the sample auditors and their SC clients see section 9.8.

Finally, the cross-tabulation of answers to the key questions (see 6.6) failed to reject the hypothesis of similar responses from prompt and late respondents. Accordingly, there is little evidence to suggest that the responses to the questionnaires are unrepresentative of the opinions and characteristics of auditors of SCs as a whole.

9.3 Ownership and control of SCs (AQ3.1)

In order to gauge the extent of ownership and control of

SCs by their directors, the sample auditors were asked to estimate the extent of shareholdings held by directors (and their families) of their SC clients. According to the auditors, their SC clients' directors (and their families) had total control in 80% of the companies and owned more than 50% of the share capital (i.e. majority control) in 94% of the companies. Accordingly, the directors and their families were minority shareholders in only 6% of the companies. The following table provides an analysis of shareholdings held by the directors of the sample auditors' clients.

Table 9.1: Auditors' estimate of % of shareholdings held by their clients' directors and their families

% of shareholdings held by directors and their families	% of SCs
0%	2
1 - 25%	2
26 - 50%	2
51 - 75%	4
76 - 99%	10
100%	80
	100

The above findings are comparable with those of the directors in respect of their own shareholdings and also with the findings by Page (1981) as reported in the directors' survey (see 8.3), where their implications were considered in detail.

9.4 Advantages and disadvantages of incorporation

Advantages of incorporation (AQ3.2)

Auditors were asked to indicate what they considered the main advantages of incorporation for SCs. Their responses are summarised below:

Table 9.2: The main advantage of incorporation

	% of respondents	
	This survey	Page's survey
Limitation of liability	59	70
Tax saving	13	18
Ease of transfer of ownership	13	8
Ability to raise finance	9	-
Rights and duties of shareholders and directors are defined	3	-
Other (incl. not answered)	3	4
	100	100

"Limitation of liability" was considered by 59% of the auditors to be the main advantage of incorporation, followed by "tax saving" (13%), "ease of transfer of ownership" (13%) and "ability to raise finance" (9%).

The above findings are comparable with those of the directors' survey (see 8.4).

Disadvantages of incorporation (AQ3.3)

With reference to the main disadvantages of incorporation for their SC clients, the majority (52%) of the sample auditors considered the "need for an audit" to be the main disadvantage of incorporation, which is very similar to the finding in the directors' survey (50%). However, comparing this finding with that of Page (1981), it appears that more auditors than a decade ago (32%) (see Table 9.3) considered the "need for an audit" to be the main disadvantage of incorporation.

The following table provides a summary of the remaining responses relating to the main disadvantages of incorporation.

Table 9.3: The main disadvantage of incorporation

	% of respondents	
	This survey	Page's survey
Need for an audit	52	32
Government form filling	20	24
Disclosure of financial information	13	20
Tax problems	13	14
Other (incl. not answered)	2	10
	100	100

It is interesting to note from the above table that the remaining findings are also similar to those of the directors' survey (see 8.4).

9.5 Users of SC accounts and their accounting information needs

In this section, the views of the sample auditors were sought with respect to the main users of SC accounts. Furthermore, it was felt important within the scope of this survey to consider what the sample auditors thought the Inland Revenue and banks were primarily looking for when examining their SC clients' annual accounts. The possible uses of the annual accounts by employees were also considered.

The main users of SC accounts

Bearing in mind the main reasons for preparing accounts (see section 8.5), the sample auditors were asked to rank in order of importance the main users of SC's full annual accounts, which are summarised in the following table:

Table 9.4: The main users of SC accounts

	% of respondents	
	This survey	Page's survey
Tax authorities	37	33
Management/directors	33	46
Banks and loan creditors	22	13
Shareholders	8	7
Employees	-	-
Business contacts	-	1
	100	100

(Note: Throughout this Chapter, where respondents were requested to rank items in order of importance, their responses have been reported on the basis of the number of first ranks accorded by the respondents. For further details see section 6.7).

From the table, "tax authorities" were considered by 37% of the auditors to be the most important user of the annual accounts, which is comparable with the finding of the directors' survey (35%). Since it appears that the tax authorities are the most important users of the annual accounts, their views on the SCFR need to be considered.

The respondents considered "management/directors" as the next most important user of the annual accounts. This is inconsistent with the finding of the directors' survey, where banks and providers of finance were considered by the directors to be the second most important user.

As can been seen from the above table, in Page (1981)'s survey, "management/directors" were considered the most important user of the accounts, indicating a change of emphasis of the use of accounts by SC directors.

Tax authorities (AQ4.5 and AQ4.4)

Judging by the high response accorded to the "tax authorities", the sample auditors were asked what they considered the Inland Revenue were primarily looking for when their SC client's annual accounts were examined by the Inland Revenue.

In response, the majority (80%) of the auditors considered the Inland Revenue were primarily looking for "profit and loss account items". A similar result was found in the directors' survey (71%). The following table provides a summary of the auditors' responses in this regard.

Table 9.5: Auditors' opinions about the Inland Revenue's information needs

	% of respondents
Profit and loss account items	80
Trading account items	62
Balance sheet items	34
Audit report	18
Auditors' reputation	17
Other	3

It should be pointed out that "audit report" and "auditors' reputation" were not accorded a high priority by the respondents. In this regard, it is interesting to note that the majority of auditors (55%) did not consider that the Inland Revenue placed greater reliance on the audited accounts of SCs than on the unaudited statements received from sole traders and partnerships (AQ4.4). This finding appears to be contrary to the result reported by Freedman and Godwin (1993:117) where it was observed that "Auditors reported more investigations and checks of unaudited accounts [by the Inland Revenue]...".

Banks (AQ4.3)

With respect to banks, the sample auditors were asked what they considered the banks were primarily looking for when their SC client's annual accounts were examined by the banks. The following table gives a summary of the auditors' responses in this regard.

Table 9.6: Auditors' opinions about the bank's information needs

	% of respondents
Liquidity	62
Trends of performance	56
Interest coverage by profit	51
Gearing	46
Stability	42
Growth	29
Audit report	19
Auditors' reputation	10

The majority of auditors considered that information about "liquidity" (62%), "trends of performance" (56%) and "interest coverage by profit" (51%) were the main items the banks were primarily looking for when they examined the SC accounts. As reported in the case of "tax authorities", the respondents accorded relatively low priority to "audit report" and "auditors' reputation".

Employees (AQ4.6)

The APC (1979) argues that employees are likely to make use of the audited accounts as a tool for wage negotiations or to assess the prospective viability of their employers' company. However, according to the majority of the sample auditors, this appears not to be the case.

9.6 <u>Form and content of SC accounts</u> (AQ4.19, AQ4.20, AQ4.21 and AQ4.22)

Considering that the form and content of SC accounts have been the subject of various public debates (for example, LSCA, 1992), it was considered necessary to seek the views of the experts (auditors). In this regard, the sample auditors' opinions on the preparation of only "one set of accounts" for both shareholders and public filing, and on their benefits and contents, were sought.

The overwhelming majority (78%) of auditors considered that only "one set of accounts" should be prepared for both shareholders of SCs and public filing (AQ4.19). A similar result was found in the directors' survey (77%).

The sample auditors' views about the benefits of "one set of accounts" are summarised in the following table:

Table 9.7: Auditors' opinions about the benefits of "one set of accounts"

	% of respondents		
	Yes	No	Not answered
Improve the use of publicly filed information	49	38	13
Reduce the burden of accounting requirements on SCs	61	27	12
Reduce the associated audit effort	50	35	15

As can be seen from the table, the majority considered that "one set of accounts" would "reduce the burden of accounting requirements on SCs". This may be due to additional costs incurred in preparing two sets of accounts (see DTI, 1995:50). This may also explain why the majority of SCs do not appear to prepare abbreviated accounts in addition to full accounts (see DTI, 1994, Appendix C: Table 1). In this survey, for instance, according to the auditors' estimates, about 48% of their SC clients on average filed abbreviated accounts (AQ4.7). In this respect, a large number of the auditors claimed that preparation of full accounts (AQ4.17) and abbreviated accounts (AQ4.18) was "a waste of time and money". Indeed, 49% of auditors claimed that "the cost of producing full annual accounts outweighs the benefits derived from them" (AQ4.11). Furthermore, although the majority did not consider that full accounts were "intrusive into the owner's private affairs" (AQ4.17), they claimed that the full accounts of SCs were not even "useful for shareholders" (AQ4.17).

With respect to other perceived benefits, 49% of respondents claimed that "one set of accounts" would "improve the use of publicly filed information". In this regard, it should be pointed out that the majority of respondents claimed that abbreviated accounts were not useful for business or investment decisions or for public use (AQ4.18).

The majority of auditors indicated that the proposed "one set of accounts" should include a detailed directors' report, a shortened profit and loss account, a full balance sheet and relevant notes. There was no support for a cash/fund statement. It is interesting to note that the majority of auditors considered "profit before tax" (76%) and "turnover (sales)" (59%) should be publicly disclosed in SC accounts (AQ4.16), probably because they were important for business decisions (AQ4.2). However, there was no majority support for the disclosure of details of the directors' emoluments (AQ4.16).

Finally, the majority of the sample auditors (80%) were of the opinion that the right to prepare and publish "one set of accounts" should apply <u>at least</u> to all <u>small owner-managed</u> companies (AQ4.22).

9.7 Definition of a SC and the application of accounting standards to SCs (AQ4.12 and AQ4.11)

The application of accounting standards to SCs has been a controversial issue. Carsberg et al (1985) found that some standards were well accepted by SC auditors as applicable to SCs (e.g. SSAP2 and SSAP9). Furthermore, as discussed in chapter 4, the ASC (1988b:para. 5.1) had accepted that there was a case, in specific circumstances, for exempting small entities from certain provisions of accounting standards. However, the CCAB working party on "Big GAAP/Little GAAP" has proposed that all SCs as defined by the CA 1985 (for filing abbreviated accounts) should be exempted from all but a handful of accounting standards (see section 4.11).

In this regard, the sample auditors' opinions were sought on the thresholds used for the definition of a SC in accordance with the CA 1985 and the application of accounting standards to SCs.

The highest proportion (46%) of auditors thought that the thresholds used for the definition of a SC (i.e. limits based on turnover (sales), balance sheet total and average number of employees) should not be changed (AQ4.23). However, 39% of respondents favoured the extension of the thresholds, which, in fact, were subsequently increased (see list of definitions). In addition, the DTI (1995) is considering a proposal to increase by up to 50% these thresholds, as well as those used for defining a medium-sized company under the Act, which would mean that a further 11,000 companies could move from medium-sized to small (DTI, 1995:7). If the ceilings for SCs are increased as suggested by the DTI (1995), any exemptions from accounting standards that are agreed by the CCAB working party would apply up to the new ceilings (see DTI, 1995:8).

With reference to the application of accounting standards to SCs, the sample auditors were provided with a list of some of the important accounting standards (AQ4.12), of which only three (SSAP 6, 9 and 12) were considered applicable to SCs by the majority of the auditors. The following table provides a summary of their responses in this regard.

Table 9.8: Auditors' opinions about application of accounting standards to SCs

	% of respondents
SSAP 9 :Stocks and Work in Progress	78
SSAP 12:Accounting for depreciation	59
SSAP 6 :Extraordinary items and prior year adjustments	56
SSAP 21:Accounting for leases and hire purchase contracts	40
SSAP 15:Accounting for deferred taxation	22
FRS1 :Cash flow statement	21
None of the above	13

As can be seen from the above table, the majority (79%) were against the application of FRS1 (cash flow statement) to SCs. This supports the current accounting requirement which exempts SCs from the application of FRS1. It is interesting to note that only a minority (13%) of the sample auditors claimed that "none of the above" accounting standards should apply to SCs.

In response to a general question in this field, the majority (66%) indicated that "there is a need for introduction of separate accounting and auditing standards for small companies" (AQ4.11).

It is worthy of note that, with reference to Companies Act requirements, 77% of the sample auditors claimed that "the current Companies Act requirements for small companies are unnecessarily complex and burdensome" (AQ4.11).

9.8 The accountants' role in SCs

With reference to the range of services provided by auditors, the sample auditors were asked to rank them in the order of importance to their SC clients.

In response, the majority (54%) ranked the "preparation of accounts" as the most important service provided to their SC clients. This finding is different from that found (i.e. tax advice) in the directors' survey.

The following table provides a summary of the auditors' views of the perceived importance to SC clients of the services they provide.

Table 9.9: Importance of services provided by SC accountants

	% of respondents
Preparation of accounts	54
Tax advice	27
Business advice	14
Audit of accounts	3
Company secretarial services	-
Other (incl. not answered)	2
	100

It is interesting to observe that only 3% of the auditors considered that the "audit of accounts" was the most important service provided compared to 23% of directors in the directors' survey. The latter appears to accord higher importance to the "audit of accounts" than the sample auditors.

Generally speaking, although many auditors provide "company secretarial services" for their SC clients, not much importance was attached to this service in this survey. This might be because "company secretarial services" are not often considered to be distinct from the preparation of accounts and audit.

Despite the above importance accorded to the services provided by the auditors, it is noteworthy that the auditors claimed that their clients, on average use the following services (AQ6.2):

Table 9.10: Services used by SC clients

	Average* % of clients
Preparation of accounts	77
Audit of accounts	84
Tax advice	83
Business advice	68
Company secretarial services	68

(* Calculated as a weighted average of the mid-points of a five-category scale: 0-20%, 21-40%, 41-60%, 61-80%, 81-100%).

It is worth mentioning that although the majority of the SC clients claimed to use the "audit of accounts" service provided by their auditors, only 3% of the auditors accorded any importance to this service (see Table 9.9). A similar situation may be observed in the case of "company secretarial services".

AUDITORS' ATTITUDES TO SC AUDIT ISSUES

In the remaining part of this Chapter, the sample auditors' opinions on a number of audit issues relating to SCs were sought. First of all, their views on the benefits of audit to their SC clients, the effect of audit regulation, their difficulties in auditing SCs and the effects of the withdrawal of the old "example 6" audit report, were ascertained.

Their views about possible changes to the audit requirement for different categories of SCs were sought, and the possible effects on the quality of their services and their income were investigated. The effects of the replacement of an audit with a statutory review were also considered.

9.9 SC Audit: benefits and difficulties (AQ5.1, AQ5.2 and AQ5.3)

In response to the question as to what they considered the main benefit to SC clients of having an annual audit, the highest proportion (39%) of auditors claimed that there was "no significant benefit". By comparison, a lower percentage (20%) of the directors surveyed claimed there was "no significant benefit".

Furthermore, only 8% of the auditors (compared to 20% of the directors) considered "assurance of efficient financial management" to be the main benefit of an annual audit to their SC clients. These findings may indicate that, to some extent, the sample auditors underestimate the value and benefit of an audit to their SC clients. In the following table, a summary of the auditors' responses on the main benefits of audit to their SC clients is provided.

Table 9.11: Auditors' opinions about the main benefit of annual audit to SCs

	% of respondents
Easier acceptance of tax computations	26
To satisfy the bank's lending requirements	22
Assurance of efficient financial management	8
No significant benefit	39
Other (incl. not answered)	5
	100

A higher proportion of the respondents considered "easier acceptance of tax computations" to be the main benefit of the annual audit to SC clients, rather than "to satisfy the bank's lending requirements". However, the directors' survey produced findings in the reverse.

A notable point regarding the above results as compared with those of Page (1981:78) is that only 15% of the respondents in Page's survey compared to 39% of those in this survey thought there was no significant advantage in an annual audit to their SC clients. This may indicate that the auditors' perception of the benefit of an audit to a SC client is now lower than a decade ago, probably because of increased audit costs arising from audit regulation under the CA 1989 (see section 5.4 and also Fearnley and Page, 1993). Indeed, 59% of the sample auditors claimed that "the regulation of auditors under the Companies Act 1989 has resulted in extra costs to auditors which are passed to their audit clients" (AQ4.11).

With reference to the difficulties auditors experience in carrying out an audit of SCs, nearly half of them ranked "lack of internal control" as the main area of difficulty (AQ5.2). It would appear that this is a common problem in a SC audit (see for example, Bryan and Rouse, 1984).

The following table provides the main difficulties in auditing SCs, ranked in order of importance by the auditors.

Table 9.12: Auditors' opinions about the main difficulties in auditing SCs

	% of respondents
Lack of internal control	50
Stock valuation	21
Understatement of sales	12
Confirmation of going-concern basis	9
Discovery of all creditors and other liabilities	7
Other (incl. not answered)	1
	100

As can be seen from the table, "stock valuation" and "understatement of sales" were considered the second and third main areas of difficulty in auditing SCs respectively.

It should be pointed out that a number of commentators, for example Schaps et al (1984), have argued that, due to the lack of segregation of duties and the possible override of internal controls by directors, it may prove difficult for auditors to rely on internal controls and they may thus consider placing more emphasis on the verification of transactions and balances. However, where independent confirmation of the completeness of the accounting records was not available, auditors had to qualify their audit report, often using the "example 6" audit report, where auditors effectively accepted assurances from the directors that all the company's transactions had been reflected in the records. Due to the extensive use of this type of audit report for SCs, it was withdrawn in 1989.

With this in mind, the sample auditors were asked whether they considered withdrawal of the old "example 6" audit report had helped them in their reporting. The majority of the auditors (72%) rejected this proposition. Furthermore, the majority of respondents (67%) claimed that the understandability of the audit report had not improved either. This may be due to the lack of a suitable replacement for the old "example 6" audit report.

Finally, as argued by the APC (1979:72), a widespread increase in qualifications in this context could possibly have harmed the standing of SCs' audited accounts. Therefore, it was felt that the withdrawal of the old "example 6" audit report might gain some support in favour of the argument to maintain audits for SCs. However, the majority of the sample auditors (73%) declined to support this proposition.

9.10 Auditors' attitudes to possible changes in audit requirement for different categories of SCs

In sections 5.7 and 5.8, alternatives to the SC audit and sub-categories of SCs to which these might apply were considered. With these in mind, the sample auditors' attitudes to possible changes in audit requirement for different categories of SCs, and their possible effects, were investigated.

With respect to Very SCs, the majority (83%) of the auditors claimed that audit requirement for such companies (i.e. private companies with a turnover below the VAT registration threshold) should be abolished (AQ5.6).

When the sample auditors were asked whether audit requirement for proprietary companies (i.e. private owner-managed companies with a turnover in excess of the VAT registration threshold but less than 25% of the turnover limit of a SC as defined by the CA 1985) should be changed, subject to a number of given possibilities (AQ5.7), the sample auditors provided the following responses which have been summarised in the table below:

Table 9.13: Auditors' attitudes to change of audit requirement for proprietary companies

The audit requirement for proprietary companies should be:	% of respondents
- substituted with a review carried out by an independent, qualified accountant	44
- abolished without any substitution	25
- retained	18
- substituted with a compilation report provided by a non-independent but qualified accountant	11
- other	2
	100

According to the above summary, the highest proportion (44%) of the auditors indicated that audit requirement for proprietary companies should be substituted with a review.

However, it is notable that when the sample auditors were asked a direct question about their views on replacing the audit with a statutory review, the majority said this would create confusion, despite the possible reduction in overall costs (AQ5.4). Perhaps with this in mind, the Chancellor of the Exchequer in his November 1993 Budget, proposed replacement of the audit with a compilation report for SCs with a turnover between £90,000 and £350,000 per annum (see section 5.8.2). In addition, it has been claimed that a compilation report alternative may provide a greater cost saving than a review (see section 5.7).

With reference to <u>other private SCs</u> (in this case, those with turnover in excess of the VAT registration threshold but less than the turnover limit of a SC as defined by the CA 1985), the highest proportion of the sample auditors claimed that their audit requirement should be retained (AQ5.8).

The following table provides a summary of the sample auditors' responses in this regard.

Table 9.14: Auditors' attitudes to change of audit requirement for other SCs

	% of respondents
The audit requirement for all other private SCs should be:	
- retained	
* subject to development of separate auditing standards	23
* without any change	21
	--
	44
- substituted with a review	33
- substituted with a compilation report	12
- abolished without any substitution	10
- other	1

	100
	===

It is interesting to note that, again, a review alternative received greater support than a compilation report.

In investigating the possible effects of SC audit abolition, three main areas were investigated, namely: the effects on the quality of the auditors' services, their income, and the extent of support for voluntary audit among their clients.

With reference to the effects of SC audit abolition on the quality of their services, the auditors' responses are summarised in the following table.

Table 9.15: The effect of SC audit abolition on the quality of auditors' services

	% of respondents
Improve (e.g. because they can concentrate on matters more important to SCs)	52
Stay much the same	35
Deteriorate (e.g. because SCs would not be willing to pay for beneficial services which are incidental to an audit)	13
	100

It is evident from the above table that the majority of the auditors were of the opinion that the quality of their services to SC clients would improve if the audit requirement for SCs were abolished.

Concerning the possible effect of SC audit abolition on their income, the majority (53%) of the auditors estimated that their income would at least stay much the same (AQ5.5).

The table below gives a summary of the auditors' views in this regard.

Table 9.16: The effect of SC audit abolition on the income of auditors' practice

	% of respondents
Stay much the same	42
Decrease a little	37
Decrease significantly	10
Increase a little	9
Increase significantly	2

	100
	===

Furthermore, with regard to reduction in fees, it should be pointed out that a 19% reduction was the average estimate of the change in charges if a review was performed instead of an audit. However, a reduction of 29% was found to be the average estimate if neither audit nor review was performed (AQ5.10).

As to the possibility of their clients choosing whether or not to have a voluntary audit if the statutory audit was abolished, the sample auditors estimated 61% of SCs would choose not to have a voluntary audit. However, the auditors estimated that 15% of SCs would no longer employ an accountant at all.

9.11 Summary and conclusion

The summary of the main findings of the auditors' survey is presented below. Similar findings were observed in both the directors' and auditors' surveys in a number of areas; for example, ownership and control of SCs, the main advantages and disadvantages of incorporation, and the main users of the annual accounts of SCs.

Other areas of similarity related to the most important financial factors for business decisions (e.g. profit before tax) and the need for disclosure of "profit before tax" and "turnover" in published accounts of SCs. Furthermore, both groups of respondents in the surveys appeared to support the preparation of "one set of accounts" for both the shareholders of SCs and filing with the Registrar of Companies.

The majority of auditors claimed that the current Companies Act requirements for SCs were unnecessarily complex and burdensome and that the regulation of auditors under the Companies Act 1989 had resulted in extra costs to auditors which were passed to their audit clients. Furthermore, the majority of auditors supported the introduction of separate auditing and accounting standards for SCs. With regard to the CA 1985 thresholds for defining a SC, the survey provided evidence of a division in opinion among the sample auditors.

The preparation of accounts was considered by the majority of the auditors to be the most important service provided to their clients, followed by tax and business advice. (In the survey of directors, tax advice was considered the most important service provided to them, followed by preparation of the accounts and the audit). The sample auditors claimed that lack of internal control, stock valuation and understatement of sales, were the main areas of difficulties in auditing SCs.

With reference to the main benefits of an annual audit to SCs, "easier acceptance of tax computations" was considered by the sample auditors to be more important than "to satisfy the bank's lending requirements". However, a reverse order of the above findings was observed in the directors' survey. Furthermore, a higher proportion of auditors than directors claimed there was no significant benefit for SCs in having annual audits.

The majority of auditors claimed that the withdrawal of the old "example 6" audit report had not helped them in their reporting nor had it improved the understandability of the SC audit report.

With regard to audit requirements for different categories of SCs, the majority of auditors claimed that the audit requirement for "Very small" private companies should be abolished. In the case of proprietary (owner-managed) and other SCs, there were no clear majority views. However, the highest proportion of auditors claimed that the audit requirement for private proprietary companies should be substituted with a <u>review</u> carried out by an independent and qualified accountant, whereas the highest proportion of the sample auditors claimed that the audit requirement of other private SCs should be <u>retained</u>.

The majority of the auditors claimed that if the audit requirement of SCs was abolished, the quality of their overall services to SC clients would improve, and the income of their practice would at least stay much the same.

To conclude, the main findings of the auditors' survey call for simplification of form and content of SC accounts and relaxation of audit requirements for some categories of SCs.

These findings indicate that the current practice is in some way incompatible with the existing aims and objectives within the theoretical framework for company auditing. Accordingly, in order to reconcile practice with aims and objectives in a SC context, perhaps it is necessary to change the existing aims and objectives.

SUPPLEMENT TO CHAPTER 9

FULL LIST OF RESPONSES BY THE SAMPLE AUDITORS OF PRIVATE SCs TO THE QUESTIONNAIRE IN APPENDIX 3

Table No.

SECTION 1: Personal information

AQ1.1: Auditors' status

Are you (or were you during the last three years) the auditor of one or more private companies?

	% of respondents
i) Yes	100
ii) No	-

	100
	===

AQ1.2: Auditors' age group

Your age group:

	% of respondents
i) under 30	8
ii) 30 - 45	46
iii) 46 - 60	37
iv) above 60	9

	100
	===

AQ1.3: Auditors' position in the firm

What is your position in the firm?

	% of respondents
i) partner	79
ii) manager	12
iii) other	9

	100
	===

AQ1.4: Auditors' period of membership of a professional accountancy body

How many years have you been a member of a professional accountancy body?

	% of respondents
i) under 5 years	11
ii) 5 - 10 years	16
iii) 11 - 20 years	29
iv) 21 - 30 years	27
v) over 30 years	17

	100
	===

Table No.

AQ1.5: Auditors' period of employment with the present firm

How many years have you worked for your present firm?

	% of respondents
i) under 5 years	29
ii) 5 - 10 years	19
iii) 11 - 20 years	24
iv) 21 - 30 years	20
v) over 30 years	8
	100

SECTION 2: Your firm

AQ2.1: Auditors' practice - description

How would you describe your practice?

	% of respondents
i) local/regional	88
ii) national	9
iii) international	3
	100

AQ2.2: Auditors' practice - No. of partners

How many partners are there in your firm?

	% of respondents
i) 1 (sole practitioner)	46
ii) 2 - 5	35
iii) 6 - 10	8
iv) 11 - 20	5
v) 21 - 50	1
vi) over 50	5
	100

Table No.

AQ2.3: Auditors' practice - No. of staff

How many professional staff (excluding partners) are there in your firm?

		% of respondents
i)	0 - 10	76
ii)	11 - 25	10
iii)	26 - 50	3
iv)	51 - 100	3
v)	101 - 200	3
vi)	over 200	5
		100

SECTION 3: Your small company clients

AQ3.1: Auditors' estimate of % of share holdings held by their clients' directors and their families

Please estimate on average what percentage of your small company clients have directors (including their families) with the following levels of shareholdings:

	% of shareholdings held by directors and their families	% of SCs
i)	0%	2
ii)	1 - 25%	2
iii)	26 - 50%	2
iv)	51 - 75%	4
v)	76 - 99%	10
vi)	100%	80
		100

Table No.

AQ3.2: The main advantage of incorporation

What do you consider to be the main advantage to a typical proprietor of a small company of running their business as a company rather than as a partnership or as an individual?

	% of respondents	Page's survey
i) limitation of liability	59	70
ii) tax saving	13	18
iii) ease of transfer of ownership	13	8
iv) ability to raise finance	9	-
v) rights and duties of shareholders and directors are defined	3	-
vi) other (incl. not answered)	3	4
	100	100

AQ3.3: The main disadvantage of incorporation

What do you consider to be the main disadvantage to a typical client of running their business as a company?

	% of respondents	Page's survey
i) need for an audit	52	32
ii) government form filling	20	24
iii) disclosure of financial information	13	20
iv) tax problems	13	14
v) other (incl. not answered)	2	10
	100	100

Table No.

SECTION 4: Small company accounts

AQ4.1: The main users of SC accounts

Please rank in order of importance the following users of small company's full annual accounts

		% of respondents	Page's survey
i)	tax authorities	37	33
ii)	management/directors	33	46
iii)	banks and loan creditors	22	13
iv)	shareholders	8	7
v)	employees	-	-
vi)	business contacts	-	1
		100	100

AQ4.2: Usefulness of annual accounts for business decision

Please rank in order of importance to users for business decisions, the following information contained in the published accounts of other private companies?

		% of respondents
i)	profit before tax	46
ii)	turnover (if stated)	16
iii)	net current assets	14
iv)	audit report	9
v)	cash/fund statement	5
vi)	gross profit	4
vii)	total assets	2
viii)	other (incl. not answered)	4
		100

Table No.

AQ4.3: Auditors' opinions about the bank's information needs

If the bank examines your small company client's annual accounts, what do you consider it is primarily looking for?

		% of respondents
i)	liquidity	62
ii)	trends of performance	56
iii)	interest coverage by profit	51
iv)	gearing	46
v)	stability	42
vi)	growth	29
vii)	audit report	19
viii)	auditors' reputation	10

AQ4.4: Auditors' opinions about the Inland Revenue's need for audited accounts

Do you consider the Inland Revenue place greater reliance on the audited accounts of small companies than on the unaudited statements received from sole traders and partnerships?

		% of respondents
i)	Yes	45
ii)	No	55
		100

AQ4.5: Auditors' opinions about the Inland Revenue' information needs

If the Inland Revenue examine your small company client's annual accounts, what do you consider they are primarily looking for?

		% of respondents
i)	profit and loss account items	80
ii)	trading account items	62
iii)	balance sheet items	34
iv)	audit report	18
v)	auditors' reputation	17
vi)	other	3

Table No.

AQ4.6: Auditors' opinions about the use of audited accounts by SCs' employees

Do you consider in a small company, the employees make any use of the audited accounts:

	% of respondents		
	Yes	No	Not answered
i) as a tool for wage negotiations	9	90	1
ii) to assess the prospective viability of their employer's company	13	82	5

AQ4.7: % of SCs filing modified accounts

Please estimate on average what percentage of your small company clients file the modified accounts rather than full accounts?

	% of respondents
i) up to 20%	37
ii) 21 - 40%	8
iii) 41 - 60%	6
iv) 61 - 80%	16
v) 81 - 100%	31
vi) not answered	2
	100

AQ4.8: Filing periods

Please estimate on average how many months after the end of their accounting reference period, your small company clients have filed their accounts with the Companies Registrar during the last year?

	% of respondents
i) up to 10 months	84
ii) 11 months	6
iii) 12 months	6
iv) 13 months	-
v) 14 months	-
vi) 15 months and more	3
vii) not answered	1
	100

Table No.

AQ4.9: Additional statements

Please estimate on average what percentage of your small company clients have filed any "additional statements" (e.g. an employee report) with their accounts with the Companies Registrar during the last year?

	% of respondents
i) 0%	95
ii) 1 - 10%	3
iii) 11 - 20%	1
iv) more than 20%	-
v) not answered	1
	100

AQ4.10: Burden of annual accounts

How should the burden of producing annual accounts for small companies be reduced?

	% of respondents
i) reduce scope of audit	55
ii) reduce disclosure	54
iii) eliminate audit	41
iv) better client book-keeping	37
v) computerisation	14
vi) not possible	1

Table No.

AQ4.11: Auditors' opinions about general questions

Which of the following statements do you agree with:

		% of respondents
i)	the cost of producing the full annual account outweighs the benefits derived from them	49
ii)	the regulation of auditors under the Companies Act 1989 has resulted in extra costs to auditors which are passed to their audit clients	59
iii)	the current Companies Act requirements for small companies are unnecessarily complex and burdensome	77
iv)	the application of the "true and fair" concept to the accounts of companies under the reduced disclosure regime is not possible	17
v)	the accounting profession should continue to attempt to make accounts more useful to users, even if the cost of preparing the information is higher	27
vi)	there is a need for introduction of separate accounting and auditing standards for small companies	66
vii)	some small companies would prefer to disincorporate in order to reduce their accounting and audit burden if favourable legal and tax reforms were in force	67

AQ4.12: Auditors' opinions about application of accounting standards to SCs

Which of the following accounting standards do you consider should apply to small companies?

			% of respondents
i)	SSAP 9	:Stocks and Work in Progress	78
ii)	SSAP 12	:Accounting for depreciation	59
iii)	SSAP 6	:Extraordinary items and prior year adjustments	56
iv)	SSAP 21	:Accounting for leases and hire purchase contracts	40
v)	SSAP 15	:Accounting for deferred taxation	22
vi)	FRS1	:Cash flow statement	21
vii)	None of the above		13

Table No.

AQ4.13: Auditors' opinions about SCs' full accounts as compared with large companies' full accounts

Do you accept that small companies should be required to prepare full accounts for the shareholders containing almost the same information as the accounts of large companies?

	% of respondents
i) Yes	25
ii) No	75

	100
	===

AQ4.14: Auditors' opinions about the level of disclosure in full accounts

In general, do you feel small companies should disclose in their full accounts

	% of respondents
i) less information	61
ii) about the same information as present	34
iii) more information	5

	100
	===

AQ4.15: Auditors' opinions about the level of disclosure in modified accounts

In general, do you feel small companies should disclose in their modified accounts

	% of respondents
i) about the same information as at present	63
ii) less information	20
iii) more information	17

	100
	===

Table No.

AQ4.16: Auditors' opinions about the extent of disclosure of some specific items

Which of the following figures should be publicly disclosed in small company accounts?

	% of respondents
i) profit before tax	76
ii) turnover (sales)	59
iii) loans from directors	56
iv) value of stock	55
v) total directors' emoluments	44
vi) details of directors' emoluments	25

AQ4.17: Auditors' opinions about full accounts

On the whole, are full accounts for the small company:

	% of respondents
i) a waste of time and money	50
ii) useful for shareholders	44
iii) intrusive into the owner's private affairs	10

AQ4.18: Auditors' opinions about modified accounts

Which of the following statements do you agree with

The modified accounts of small companies are:

	% of respondents
i) a waste of time and money	59
ii) useful for the public	15
iii) useful for business decisions	11
iv) useful for investment decisions	7
v) none of the above	14

AQ4.19: Auditors' opinions about "only one set of accounts"

Do you consider only one set of accounts should be prepared both for the shareholders of small companies and for filing?

	% of respondents
i) Yes	78
ii) No	22
	100

Table No.

AQ4.20: Auditors' opinions about the effects of "only one set of accounts"

Do you consider if only one set of accounts is prepared both for the shareholders and for filing then it will:

	% of respondents		
	Yes	No	Not answered
i) improve the use of publicly filed information	49	38	13
ii) reduce the burden of accounting requirements on SCs	61	27	12
iii) reduce the associated audit effort	50	35	15

AQ4.21: Auditors' opinions about the content of "only one set of accounts"

If only one set of accounts is prepared both for the shareholders and for filing, which of the following items should be included:

(See 9.6)

AQ4.22: Auditors' opinions about the categories of SCs which should prepare "only one set of accounts"

Do you think the right to prepare and publish only one set of accounts should apply to:

	% of respondents
i) all small companies	43
ii) small owner-managed companies only	37
iii) a sub-category of small companies	7
iv) none of these	10
v) other (incl. not answered)	3
	100

Table No.

AQ4.23: Auditors' opinions about the current thresholds used for the definition of a SC (CA 1985)

Do you think the current thresholds used for the definition of a small company should be

	% of respondents
i) left as it is	46
ii) further widened	39
iii) further narrowed	14
iv) other (incl. not answered)	1
	100

SECTION 5: Small company audit

AQ5.1: Auditors' opinions about the main benefit of annual audit to SCs

What is the main benefit small companies obtain from the annual audit?

	% of respondents
i) easier acceptance of tax computations	26
ii) to satisfy the bank's lending requirement	22
iii) assurance of efficient financial management	8
iv) no significant benefit	39
v) other (incl. not answered)	5
	100

AQ5.2: Auditors' opinions about the main difficulties in auditing SCs

Please rank in order of importance the following difficulties in auditing small companies?

	% of respondents
i) lack of internal control	50
ii) stock valuation	21
iii) understatement of sales	12
iv) confirmation of going-concern basis	9
v) discovery of all creditors and other liabilities	7
vi) other (incl. not answered)	1
	100

Table No.

AQ5.3: Auditors' opinions about the effects of the withdrawal of "example 6" audit report

Do you consider the withdrawal of the old "example 6" audit report (containing a qualification due to limitation of scope and acceptance of assurances from management in the absence of internal controls) has:

	% of respondents Yes	No	Not answered
i) helped the auditors in their reporting	27	72	1
ii) improved the understandability of the audit report	25	67	8
iii) resulted in more support for the argument to maintain the audit for small companies	18	73	9

AQ5.4: Auditors' opinions about the effects of the replacement of an audit with a statutory review

Do you consider the substitution of a statutory review in place of an audit will:

	% of respondents Yes	No	Not answered
i) create confusion over the nature and the scope of a review	59	34	7
ii) reduce the overall costs	51	42	7
iii) provide almost the same assurances as an audit	46	44	10

AQ5.5: Auditors' opinions about the effects of SC audit abolition on their income

If the audit requirement for small companies were abolished do you estimate that the income of your practice would

	% of respondents
i) stay much the same	42
ii) decrease a little	37
iii) decrease significantly	10
iv) increase a little	9
v) increase significantly	2
	100

Table No.

AQ5.6: Auditors' opinions about the change of the audit requirement for Very SCs

Should the audit requirement for private companies with turnover below the VAT threshold (currently £36,600) ("very small" companies) be abolished?

	% of respondents
i) Yes	83
ii) No	17

	100
	===

AQ5.7: Auditors' opinions about the change of the audit requirement for proprietary SCs

Should the audit requirement for private owner-managed companies with turnover in excess of the VAT threshold but less than 25% of the small companies turnover limit (currently £500,000) ("proprietary" companies), subject to unanimous decision of shareholders, be:

(See 9.10)

AQ5.8: Auditors' opinions about the change of the audit requirement for other private SCs

Should the audit requirement for all other private companies with turnover in excess of the VAT threshold but less than the turnover limit (currently £2m) be:

(See 9.10)

AQ5.9: Auditors' opinions about the effects of SC audit abolition on the quality of their services

If the audit requirement for small companies were abolished would the quality of your overall service to small company clients

	% of respondents
i) improve (e.g. because they can concentrate on matters more important to SCs)	52
ii) stay much the same	35
iii) deteriorate (e.g. because SCs would not be willing to pay for beneficial services which are incidental to an audit)	13

	100
	===

Table No.

AQ5.10: Auditors' opinions about the other effects of SC audit abolition (e.g. voluntary audit)

If audits were not compulsory, please estimate on average what percentage of:

		average (%)
i)	your small company clients would choose not to have an audit	61
ii)	your small company clients would cease to employ an accountant	15
iii)	reduction in fees you could make if a review was performed instead of an audit	19
iv)	reduction in fees you could make if no review was performed	29

SECTION 6: Your services to small company clients

AQ6.1: Services provided by SC accountants

Please rank the services you provide to your small company clients in order of importance to them :

		% of respondents
i)	preparation of accounts	54
ii)	tax advice	27
iii)	business advice	14
iv)	audit of accounts	3
v)	company secretarial services	-
vi)	other (incl. not answered)	2
		100

Table No.

AQ6.2: Auditors' statistics about their SC clients

Please estimate on average what percentage of:

		average (%)
i)	your working week is spent providing services to your small company clients?	41
ii)	your total number of clients are small companies?	49
iii)	your small company clients use the following services:	
	- preparation of accounts	77
	- audit of accounts	84
	- tax advice	83
	- business advice	68
	- company secretarial services	68
iv)	your small company clients are managed by individuals for whom personal services (e.g. income tax return) also provided	70
v)	your overall fees is from your small company clients for:	
	- all services (including audit)	53
	- audit services only	24

CHAPTER 10

CROSS ANALYSIS OF RESULTS AND TESTING OF HYPOTHESES

10.1 Introduction

This Chapter considers the results of statistical tests on three groups of hypotheses:

a) Hypotheses about directors' opinions in respect of certain SCFR variables (i.e. **Directors' hypotheses**);

b) Hypotheses about auditors' opinions in respect of certain SCFR variables (i.e. **Auditors' hypotheses**); and

c) Hypotheses about directors' v auditors' opinions in respect of certain SCFR variables (i.e. **Directors' v Auditors' hypotheses**).

Where association between variables was identified by a significant chi-square test (at 5% significance level) the degree of association was measured using the Gamma statistic (see 6.8).

The contingency tables used for testing the hypotheses (H) are presented in the second Supplement to this Chapter. There is a contingency table for each hypothesis with the same reference number (e.g. H1, H2 and so on). Where there was an association, in the case of the one-degree-of-freedom contingency table, the value of chi-square was then corrected for Yates' adjustment. The first Supplement to this Chapter includes the hypotheses which have not been supported.

10.2 Directors' hypotheses

Cross analysis of the results in the form of contingency tables provides some assurance of the consistency of the primary findings reported in Chapter 8. In particular, the following hypotheses about directors' opinions on certain SCFR variables can be supported at a significance of better than 5% on a chi-square test (see 6.8).

H1-H2) Directors who considered that the main disadvantage of incorporation was the "need for an audit" tended:

- to wish to dispense with statutory audit (H1); and

- not to choose a voluntary audit if the statutory audit requirement was removed (H2).

H3-H4) There is a positive relationship between the directors' views of the most important user of the accounts and:

- the audit function (H3); for example, the respondents who thought directors were the most important users of the accounts were inclined to think that the most important function of the audit was to report to directors; and

- the main audit benefits (H4); for example, the respondents who thought the Inland Revenue was the most important user of the accounts were inclined to think that the main benefit of an audit for SCs was the easier acceptance of tax computations.

H5-H7) The smaller the company in the sample (whether measured by the number of its directors, employees or annual turnover criteria), the more likely its directors were to be in favour of the abolition of SC audit. In particular, the directors of SCs with up to 2 directors (H5) or 5 employees (H6) or £1m annual turnover (H7) (or any combination of these three criteria, see pages 434 and 435) tended to be in favour of abolition of the SC audit. (See comments on page 391).

H8-H10) Directors who considered that "only one set of accounts" should be prepared were more inclined to think that it would:

- "improve the use of publicly filed information" (H8);

- "reduce the burden of accounting requirements on small companies" (H9); and

- "reduce the associated audit effort" (H10).

H11) Directors who considered there was no significant advantage to an SC audit tended to wish to dispense with it.

H12-H14) Directors who thought the audit requirement of SCs should be retained were more inclined to think that substitution of a statutory review for an audit would:

- not "provide almost the same assurances as audit" (H12);

- "create confusion over the nature and the scope of a review" (H13); and

- not "reduce the overall costs" (H14).

H15) Directors who chose to have a voluntary audit (in case the SC statutory audit was abolished) tended to think that an audit had benefits for their SCs.

The following table provides the degree of association between two variables in each of the above hypotheses, measured by the Gamma statistic (see 6.8):

<u>Table 10.1: Directors' Hypotheses - association between SCFR variables</u>

H1	Very Strong	H6	Substantial	H11	Perfect
H2	Moderate	H7	Moderate	H12	Substantial
H3	Substantial	H8	Very Strong	H13	Substantial
H4	Substantial	H9	Very Strong	H14	Moderate
H5	Moderate	H10	Very Strong	H15	Very Strong

As can be seen from the table, the majority of associations identified are at least "substantial", in particular:

1) there is almost a perfect association between the opinions that "there is no significant advantage to SC audit" and a "wish to dispense with statutory audit";

2) there is very strong association between the opinions that "there is no significant advantage to SC audit" and would "choose not to have a voluntary audit";

3) there is very strong association between the opinions that "audit is the main disadvantage of incorporation"

and would "wish to dispense with statutory audit"; and

4) there is very strong association between the opinions that "the preparation of one set of accounts" would "improve the use of publicly filed information", "reduce the burden of accounting requirements on small companies" and "reduce the associated audit effort".

With reference to the hypotheses H5, H6 and H7, it is worth pointing out that they are not independent of each other. An independent hypothesis based on all three criteria can be supported at a significance of better than 5% on a chi-square test, namely:

"directors of 'small' companies with up to 2 directors <u>and</u> 5 employees <u>and</u> £1m annual turnover tended to be in favour of abolition of the SC audit". (See H87 on page 435).

It should be pointed out that the associations between negative attitudes to the SC audit in the hypotheses may be restated as associations between positive attitudes. For example, in the case of the hypothesis H1, this may be restated as: directors who did <u>not</u> consider that the main disadvantage of incorporation was the "need for an audit" tended <u>not</u> to wish to dispense with statutory audit.

The first Supplement to this Chapter includes an additional 8 hypotheses (namely H16 to H23) about the directors' opinions in respect of certain SCFR issues which cannot be supported at a significance of better than 5% on a chi-square test, in particular:

1) there is no association between the opinions that "limitation of liability is the main advantage of incorporation" and "support for retention of SC audit" (H23); and

2) there is no association between the opinions of the directors of "owner-managed SCs" and a "wish to dispense with statutory audit" (H22).

10.3 Auditors' hypotheses

With regard to the sample auditors (see Chapter 9), in order to identify the main associations between their opinions, for example whether there is an association between their firms' size and SC audit benefits, a series of hypotheses (H24 to H55) were tested.

The following hypotheses about auditors' opinions in respect of certain SCFR variables can be supported at a significance of better than 5% on a chi-square test.

H24) Auditors from smaller firms tended to consider that an audit had significant benefit to their SC clients.

H25) There is a positive relationship between the auditors' views of the most important user of the accounts and the main audit benefits (e.g. the respondents who considered that banks were the most important users of the accounts were more likely to consider that the main benefit of the audit was "to satisfy the bank's lending requirements").

H26) Auditors who saw no significant audit benefit to their SC clients estimated that more than half of their SC clients would choose not to have an audit, given the option.

H27) Auditors who considered that the "need for an audit" was the main disadvantage of incorporation were more likely to consider that there was no significant audit benefit to SCs.

H28) Auditors who considered that the quality of their services to SC clients would deteriorate if the audit requirement for SCs was abolished were more likely to support retention of the audit.

H29) Auditors who considered that there would be no improvement in the overall quality of their services to SC clients if the SC audit was removed, estimated that less than the average number of their SC clients would choose not to have a voluntary audit.

H30-H32) Auditors who considered that "only one set of accounts" should be prepared were more likely to consider that it would:

- "improve the use of publicly filed information" (H30);
- "reduce the burden of accounting requirements on small companies"(H31); and
- "reduce the associated audit effort" (H32).

H33-H35) Auditors who thought the audit requirement for SCs should be retained tended to think that the substitution of a statutory review for an audit would:

- not "reduce the overall costs" (H33);
- "create confusion over the nature and the scope of a review" (H34); and
- not "provide almost the same assurances as an audit" (H35).

The degree of association between two variables in each of the above hypotheses was measured using the Gamma statistic and is presented in the following table:

Table 10.2: Auditors' hypotheses - association between SCFR variables

H24	Substantial	H28	Very Strong	H32	Substantial
H25	Moderate	H29	Substantial	H33	Moderate
H26	Very Strong	H30	Moderate	H34	Moderate
H27	Moderate	H31	Very Strong	H35	Moderate

It is possible to draw a number of interpretations from the important associations in the above table:

1) there is a very strong association between the opinions that "there is no significant audit benefit to their SC clients" and "more than half of their SC clients would choose not to have an audit, given the option" (H26);

2) there is a very strong association between the opinions that "the quality of their services to SC clients would deteriorate if the SC audit was removed" and "support for the retention of the audit requirement" (H28);

3) there is a very strong association between the opinions that "the preparation of one set of accounts" would "reduce the burden of accounting requirements on small companies" (H31); and

4) there is substantial association between the opinions of auditors of "smaller firms" and the belief that the "audit has significant benefit to their SC clients" (H24).

It should be pointed out that the remaining auditors' hypotheses (H36 to H55), which were not supported at a significance of better than 5% on a chi-square test are provided in the first Supplement to this Chapter. In particular, it is interesting to note that there was no association between:

1) the auditors' "firm size" and "the abolition of the SC audit requirement" (H38, H39 and H40);

2) the opinions that "limitation of liability was the main advantage of incorporation" and "retention of SC audit requirement" (H43); and

3) the opinions that the "need for an audit was the main disadvantage of incorporation" and the "need to remove the SC audit requirement" (H45).

10.4 Directors' v Auditors' hypotheses

In order to examine whether the proportion of respondents expressing an opinion was (or was not) the same for the sample directors and auditors, a series of hypotheses (H56 to H83) were tested.

It was found that the following hypotheses can be supported at a significance of better than 5% on a chi-square test that there are associations between the directors' and the auditors' opinions (i.e. the proportion of respondents expressing the following opinions was not the same for the sample directors as for the auditors):

H56) about the main user of SC accounts;

H57) that profit before tax was the most important indicator for business decisions in SC accounts;

H58) that <u>full</u> accounts of SCs were not intrusive into the owner's private affairs;

H59) about the importance of services provided by SCs' accountants (auditors);

H60) that abbreviated accounts of SCs were not useful for investment decisions;

H61) that abbreviated accounts of SCs were not useful for business decisions;

H62) that SCs would choose to have a voluntary audit if the SC audit was abolished;

H63) about the main benefit of SC audit; and

H64) that the SC audit should not be replaced with a statutory review.

The following table provides the degree of association between variables in the above hypotheses, measured by the Gamma statistic.

Table 10.3: Directors' v Auditors' Hypotheses - association between SCFR variables

H56	Negligible	H59	Moderate	H62	Moderate
H57	Moderate	H60	Substantial	H63	Low
H58	Moderate	H61	Substantial	H64	Moderate

A review of the above moderate and substantial associations indicates that:

1) a higher proportion of the sample auditors than directors were of the opinion that "profit before tax" was the most important indicator in SC accounts for business decisions (H57); the full accounts of SCs

were not intrusive into the owner's private affairs (H58); and the abbreviated accounts of SCs were not useful for investment (H60) or business (H61) decisions.

2) With reference to the audit, a higher proportion of sample directors (23%) than auditors (3%) considered "audit of accounts" was the most important service provided by auditors (H59). Similarly, with reference to a voluntary audit, a higher proportion of directors (56%) than auditors (39%) claimed that SCs would choose to have a voluntary audit if the statutory audit requirement for SCs was removed (H62). These findings, which are based on moderate associations, may indicate that a higher proportion of SC directors than auditors considered SC audit to be a valuable service.

Finally, the first Supplement to this Chapter includes some hypotheses (H65 to H83) about the directors' and the auditors' opinions about certain SCFR issues which were not supported; in particular, there was no association between the sample directors' and the auditors' opinions:

1) about the main advantage (H65) or disadvantage (H66) of incorporation;

2) that full accounts of SCs were not useful for shareholders (H69) or they were a waste of time and money (H70);

3) that abbreviated accounts of SCs were not useful for the public (H74) or they were a waste of time and money (H75);

4) about the perceived benefits of the preparation of "one set of accounts" (H77, H78 and H79); and

5) about retention of the SC audit requirement (H80).

10.5 Summary and conclusion

The cross analysis of results provided some confirmation of the consistency of results and identified some interesting associations between group of opinions. References to some of these associations are made below.

With regard to the primary findings about preparation of "one set of accounts", there were very strong associations between the sample directors' opinions that "one set of accounts should be prepared" and its perceived benefits (for example, it would "improve the use of publicly filed information" or "reduce the burden of accounting requirements on small companies").

With reference to an SC audit, the cross analysis of results indicated that there were very strong associations between the directors' opinions that "there is no significant advantage to SC audit" and they would "choose not to have a voluntary audit" if the SC audit requirement was removed.

The cross analysis of results also identified some other interesting associations; for example, there was a strong positive relationship between the directors' views of the most important user of the accounts and the audit function or the main audit benefits.

With regard to the size of the sample directors' company, cross analysis of results indicated that the smaller the company in the sample, the more likely its directors were to be in favour of abolition of the SC audit. However, there was no association between the opinions of the directors of "owner-managed SCs" and the "wish to dispense with statutory audit".

Cross analysis of the primary findings of the auditors' survey also identified some important associations. For example, "weaker" associations were found in respect of the sample auditors' opinions about the preparation of "one set of accounts" and its perceived benefits as compared with those of the directors' survey.

Furthermore, there was substantial association between the opinions of the auditors of "smaller firms" and "audit has significant benefit to their SC clients". However, it is worthy of note that there was no association between the auditors' "firm size" and "the abolition of the SC audit requirement".

Finally, cross analysis of the results identified among other interesting associations that a higher proportion of sample directors than of auditors were of the opinion that "audit of accounts" was the most important service and they would still choose to have a voluntary audit if the statutory audit requirement of their SCs was removed.

To conclude, in addition to providing some confirmation of the consistency of results, cross analysis of the results also identified some diversity of opinion among the sample directors and auditors about certain SCFR issues. One of the most important implications of this finding is that it is rather difficult for decision makers to formulate any lasting policy to satisfy the needs of different users of SC accounts, particularly in relation to form and content of SC accounts and SC audit requirement.

FIRST SUPPLEMENT TO CHAPTER 10

HYPOTHESES NOT SUPPORTED

The following hypotheses cannot be supported at a significance of better than 5% on a chi-square test:

H16) Directors who considered that the "disclosure of financial information" was the main disadvantage of incorporation tended to be in favour of less disclosure in the abbreviated accounts.

H17) Directors who considered that the "disclosure of financial information" was the main disadvantage of incorporation tended to be in favour of less disclosure in the full accounts.

H18) Directors who considered that the profit and loss account items were useful for business decisions tended to think that the abbreviated accounts of SCs should disclose more information.

H19) Directors who considered that their competitors might use the publicly filed information concerning their companies to their disadvantage tended to think that the "disclosure of financial information" was the main disadvantage of incorporation.

H20) Directors who considered that some competitors had already used the publicly filed information concerning their companies to their disadvantage tended to feel that SCs should disclose less information in their abbreviated accounts.

H21) Directors who thought that the audit of accounts was the most important service provided by their accountants tended to be in favour of compulsory audit for SCs.

H22) Directors who were from owner-managed SCs tended to be in favour of abolition of SC audit.

H23) Directors who considered that the main advantage of incorporation was the "limitation of liability" tended to support retention of audit (as a price for such a benefit).

H36) Auditors from smaller firms tended to consider that the "need for an audit" was not the main disadvantage of incorporation for their SC clients.

H37) Auditors from smaller firms were more likely to offer a larger reduction than average in fees if no audit was performed.

H38) Auditors from larger firms were more likely to be against <u>very</u> SC audit requirement.

H39) Auditors from larger firms were more likely to be against <u>proprietary</u> SC audit requirement.

H40) Auditors from larger firms were more likely to be against <u>other</u> SC audit requirement.

H41) Auditors who considered that the Inland Revenue placed greater reliance on the audited accounts of SCs than on the unaudited statements received from sole traders and partnerships were more likely to be in favour of SC audit requirement.

H42) Auditors who saw no significant audit benefit to their SC clients were more likely to be in favour of removal of SC audit requirement.

H43) Auditors who considered that the "limitation of liability" was the main advantage of incorporation were more likely to be in favour of SC audit (i.e. the audit requirement was justified in return for the privilege of limited liability).

H44) Auditors who considered that the "need for an audit" was the main disadvantage of incorporation estimated that more than half of their SC clients would choose not to have an audit, given the option.

H45) Auditors who considered that the "need for an audit" was the main disadvantage of incorporation were more likely to be in favour of removing SC audit.

H46) Auditors who considered that the "need for an audit" was the main disadvantage of incorporation estimated that they could make larger than average reductions in their fees if no audit was performed.

H47) Auditors who considered that the "need for an audit" was the main disadvantage of incorporation tended to think that the main difficulty in auditing SCs was their lack of internal control.

H48) Auditors who estimated that they could make larger than average reductions in fees if the audit requirement for SCs was abolished estimated a significant drop in their income.

H49) Auditors who considered that SCs would benefit from audit were more likely to consider that their overall fees could be reduced by less than average if SC audit was abolished.

H50) Auditors who considered that SCs would benefit from audit were more likely to think that a smaller proportion than average of their SC clients would choose to cease employing accountants if SC audit was abolished.

H51) Auditors who considered that less than average number of their SC clients would choose not to have a voluntary audit if SC statutory audit was removed estimated less than average reduction in their overall income.

H52) Auditors who spent on average more time on audit of SC clients were more likely to consider that the removal of audit would reduce their income significantly.

H53) Auditors who spent on average more time on audit of SC clients tended to be against the removal of SC audit.

H54) Auditors who had more than average number of SC clients were more likely to be in favour of compulsory audit for SCs.

H55) Auditors with a high proportion of SC <u>audit</u> clients were more likely to be in favour of compulsory audit.

The following hypotheses cannot be supported at a significance of better than 5% on a chi-square test that there are associations between the directors' and the auditors' opinions:

H65) about the main advantage of incorporation;

H66) about the main disadvantage of incorporation;

H67) about the main items in SC accounts used by the Inland Revenue for checking tax computations;

H68) about the need for disclosure of profit before tax in the published accounts of SCs;

H69) that <u>full</u> accounts of SCs were not useful for shareholders;

H70) that <u>full</u> accounts of SCs were a waste of time and money;

H71) that the cost of producing the full accounts outweighed the benefit derived from them;

H72) about the need to make SC accounts more useful;

H73) that SCs should not prepare full accounts containing almost the same information as the accounts of large companies;

H74) that abbreviated accounts of SCs were not useful for the public;

H75) that abbreviated accounts of SCs were a waste of time and money;

H76) that only one set of accounts should be prepared both for shareholders of SCs and public filing;

H77) that the preparation of one set of accounts would improve the use of publicly filed information;

H78) that the preparation of one set of accounts would reduce the burden of accounting requirements on SCs;

H79) that the preparation of one set of accounts would reduce the associated audit effort;

H80) about SC audit requirement;

H81) that statutory review would create confusion;

H82) that statutory review would not reduce the overall costs; and

H83) that statutory review would not provide almost the same assurances as audit.

SECOND SUPPLEMENT TO CHAPTER 10

CONTINGENCY TABLES FOR TESTING:		TABLE NO.
I)	DIRECTORS' HYPOTHESES	H1 - H23 H84 - H87
II)	AUDITORS' HYPOTHESES	H24 - H55
III)	DIRECTORS' V AUDITORS' HYPOTHESES	H56 - H83

CONTINGENCY TABLES FOR TESTING DIRECTORS' HYPOTHESES

H1 Cross analysis of directors' views about the need for an audit (as the main disadvantage of incorporation) and their attitudes to retention of SC audit

Main disadvantage of incorporation (DQ2.8)	Directors' views in respect of statutory audit requirement (DQ4.4)		
	Keep audit	Remove audit	Total
Need for an audit	8	45	53
Others	27	26	53
Total	35	71	106

ChiSq = 13.821 df = 1 ChiSq (5%) = 3.841 (association)
Gamma = -0.7077 (very strong association)

H2 Cross analysis of directors' views about their clients' choice of voluntary audit and the need for an audit (as the main disadvantage of incorporation)

Voluntary audit (DQ4.1)	Main disadvantage of incorporation (DQ2.8)		
	Need for an audit	Others	Total
Yes	24	36	60
No	29	17	46
Total	53	53	106

ChiSq = 4.647 df = 1 ChiSq (5%) = 3.841 (association)
Gamma = -0.4380 (moderate association)

H3 Cross analysis of directors' views about the main user of SC accounts and the main audit function

Main user of SC accounts (DQ3.1)	Main audit function (DQ4.3)		
	Report to directors	Others	Total
Directors	11	9	20
Others	20	66	86
Total	31	75	106

ChiSq = 6.442 df = 1 ChiSq (5%) = 3.841 (association)
Gamma = 0.6026 (substantial association)

H4 Cross analysis of directors' views about the main user of SC accounts and the main audit benefit

	Main audit benefit (DQ4.2)		
	Easier acceptance of tax computations	Others	Total
Main user of SC accounts (DQ3.1)			
Inland Revenue	18	19	37
Others	12	57	69
Total	30	76	106

ChiSq = 10.107 df = 1 ChiSq (5%) = 3.841 (association)
Gamma = 0.6364 (substantial association)

H5 Cross analysis of directors' views about SC audit requirement and their number of directors

	Directors' company size (DQ2.4)		
	Up to 2 directors	More than 2 directors	Total
Directors' views in respect of audit requirement (DQ4.4)			
Keep audit	14	21	35
Remove audit	45	26	71
Total	59	47	106

ChiSq = 4.288 df = 1 ChiSq (5%) = 3.841 (association)
Gamma = -0.4439 (moderate association)

H6 Cross analysis of directors' views about SC audit requirement and their number of employees

	Directors' company size (DQ2.5)		
	Up to 5 employees	More than 5 employees	Total
Directors' views in respect of audit requirement (DQ4.4)			
Keep audit	10	25	35
Remove audit	40	31	71
Total	50	56	106

ChiSq = 6.182 df = 1 ChiSq (5%) = 3.841 (association)
Gamma = -0.5267 (substantial association)

H7 Cross analysis of directors' views about SC audit requirement and their annual turnover

Directors' views in respect of audit requirement (DQ4.4)	Directors' company size (DQ2.6): Up to £1m turnover	More than £1m turnover	Total
Keep audit	19	16	35
Remove audit	55	16	71
Total	74	32	106

ChiSq = 4.927 df = 1 ChiSq (5%) = 3.841 (association)
Gamma = -0.4865 (moderate association)

H8 Cross analysis of directors' views about preparation of only one set of accounts and improvement in the use of publicly filed information

Prepare only one set of accounts (DQ3.27)	One set of accounts would improve the use of publicly filed information (DQ3.28): Yes	No	Total
Yes	45	37	82
No	2	22	24
Total	47	59	106

ChiSq = 14.466 df = 1 ChiSq (5%) = 3.841 (association)
Gamma = 0.8609 (very strong association)

H9 Cross analysis of directors' views about preparation of only one set of accounts and reduction in the burden of accounting requirements on SCs

Prepare only one set of accounts (DQ3.27)	One set of accounts would reduce the burden of accounting requirements on SCs (DQ3.28): Yes	No	Total
Yes	68	14	82
No	6	18	24
Total	74	32	106

ChiSq = 26.876 df = 1 ChiSq (5%) = 3.841 (association)
Gamma = 0.8716 (very strong association)

H10 Cross analysis of directors' views about preparation of only one set of accounts and reduction in the associated audit effort

Prepare only one set of accounts (DQ3.27)	One set of accounts would reduce the associated audit effort (DQ3.28) Yes	No	Total
Yes	54	28	82
No	5	19	24
Total	59	47	106

ChiSq = 13.478 df = 1 ChiSq (5%) = 3.841 (association)
Gamma = 0.7599 (very strong association)

H11 Cross analysis of directors' views about SC audit benefit and SC audit requirement

Audit benefit (DQ4.2)	Directors' views in respect of statutory audit requirement (DQ4.4) Keep audit	Remove audit	Total
Other	35	50	85
No significant advantage	0	21	21
Total	35	71	106

ChiSq = 11.115 df = 1 ChiSq (5%) = 3.841 (association)
Gamma = 1 (perfect association)

H12 Cross analysis of directors' views about SC audit requirement and assurances provided if review substitutes SC audit

Directors' views in respect of audit requirement (DQ4.4)	Review would provide almost the same assurances as audit (DQ4.5) Yes	No	Total
Keep audit	10	25	35
Remove audit	40	31	71
Total	50	56	106

ChiSq = 6.182 df = 1 ChiSq (5%) = 3.841 (association)
Gamma = -0.5267 (substantial association)

H13 Cross analysis of directors' views about SC audit requirement and confusion created if review substitutes SC audit

	Review would create confusion over its nature and scope (DQ4.5)		
	Yes	No	Total
Directors' views in respect of audit requirement (DQ4.4)			
Keep audit	27	8	35
Remove audit	32	39	71
Total	59	47	106

ChiSq = 8.515 df = 1 ChiSq (5%) = 3.841 (association)
Gamma = 0.6089 (substantial association)

H14 Cross analysis of directors' views about SC audit requirement and reduction in overall costs if review substitutes SC audit

	Review would reduce the overall costs (DQ4.5)		
	Yes	No	Total
Directors' views in respect of audit requirement (DQ4.4)			
Keep audit	10	25	35
Remove audit	38	33	71
Total	48	58	106

ChiSq = 4.926 df = 1 ChiSq (5%) = 3.841 (association)
Gamma = -0.4844 (moderate association)

H15 Cross analysis of directors' views about their clients' choice of voluntary audit and audit benefits

	Audit has significant benefit (DQ4.2)		
	Yes	No	Total
Voluntary audit (DQ4.1)			
Yes	57	3	60
No	26	20	46
Total	83	23	106

ChiSq = 20.482 df = 1 ChiSq (5%) = 3.841 (association)
Gamma = 0.8719 (very strong association)

H16 Cross analysis of directors' views about the main disadvantage of incorporation and the level of disclosure in SC abbreviated accounts

Main disadvantage of incorporation (DQ2.8)	Less disclosure in abbreviated accounts (DQ3.14) Yes	No	Total
Disclosure of financial information	2	12	14
Others	30	62	92
Total	32	74	106

ChiSq = 1.936 df = 1 ChiSq (5%) = 3.841 (no association)

H17 Cross analysis of directors' views about the main disadvantage of incorporation and the level of disclosure in SC full accounts

Main disadvantage of incorporation DQ2.8)	Less disclosure in full accounts (DQ3.14) Yes	No	Total
Disclosure of financial information	4	10	14
Others	41	51	92
Total	45	61	106

ChiSq = 1.272 df = 1 ChiSq (5%) = 3.841 (no association)

H18 Cross analysis of directors' views about information for business decisions and the level of disclosure in SC abbreviated accounts

Useful information in the accounts for business decisions (DQ3.5)	More disclosure in abbreviated accounts (DQ3.14) Yes	No	Total
Profit and loss account items	3	48	51
Others	7	48	55
Total	10	96	106

ChiSq = 1.451 df = 1 ChiSq (5%) = 3.841 (no association)

H19 Cross analysis of directors' views about misuse of public information by SC competitors and the main disadvantage of incorporation

Misuse of public information by competitors (DQ3.9)	Main disadvantage of incorporation (DQ2.8): Disclosure of financial information	Others	Total
Yes	2	4	6
No	12	88	100
Total	14	92	106

ChiSq = 2.247 df = 1 ChiSq (5%) = 3.841 (no association)

H20 Cross analysis of directors' views about misuse of public information by SC competitors and the level of disclosure in SC abbreviated accounts

Misuse of public information by competitors (DQ3.9)	Less disclosure in abbreviated accounts (DQ3.14): Yes	No	Total
Yes	1	5	6
No	31	69	100
Total	32	74	106

ChiSq = 0.552 df = 1 ChiSq (5%) = 3.841 (no association)

H21 Cross analysis of directors' views about services provided by their accountants/auditors and SC audit requirement

Most important services provided by accountants (DQ3.19)	Directors' views in respect of statutory audit requirement (DQ4.4): Keep audit	Remove audit	Total
Audit	9	15	24
Others	26	56	82
Total	35	71	106

ChiSq = 0.282 df = 1 ChiSq (5%) = 3.841 (no association)

H22 Cross analysis of views of directors from owner-managed SCs and other SCs in respect of SC audit requirement

	Directors' views in respect of statutory audit requirement (DQ4.4)		
	Keep audit	Remove audit	Total
Directors were from (DQ1.1)			
Other SCs	12	17	29
Owner-managed SCs	23	54	77
Total	35	71	106

ChiSq = 1.262 df = 1 ChiSq (5%) = 3.841 (no association)

H23 Cross analysis of directors' views about SC audit requirement and the main advantage of incorporation

	Main advantage of incorporation (DQ2.7)		
	Limitation of liability	Others	Total
Directors' views in respect of statutory audit requirement (DQ4.4)			
Keep audit	17	18	35
Remove audit	40	31	71
Total	57	49	106

ChiSq = 0.569 df = 1 ChiSq (5%) = 3.841 (no association)

CONTINGENCY TABLES FOR TESTING AUDITORS' HYPOTHESES

H24 Cross analysis of auditors' practice size and their views about SC audit benefits

Accountancy firm size (AQ2.2)	Audit has significant benefit to their SC clients (AQ5.1) Yes	No	Total
Small (up to 5 partners)	63	61	124
Not Small	22	7	29
Total	85	68	153

ChiSq = 5.004 df= 1 ChiSq (5%) = 3.841 (association)
Gamma = -0.5053 (substantial association)

H25 Cross analysis of auditor's views in respect of the main user of SC accounts and the main benefit from SC audit

Main user of SC accounts (AQ4.1)	Main benefit from SC audit (AQ5.1) To satisfy the bank's lending requirements	Others	Total
Banks and other loan creditors	12	21	33
Others	21	99	120
Total	33	120	153

ChiSq = 4.386 df = 1 ChiSq (5%) = 3.841 (association)
Gamma = 0.4586 (moderate association)

H26 Cross analysis of auditors' views about SC audit benefits and their clients' choice of voluntary audit

SC audit has significant benefit (AQ5.1)	% of SC clients would choose not to have a voluntary audit (AQ5.10) Less than 50%	More than 50%	Total
Yes	43	42	85
No	9	59	68
Total	52	101	153

ChiSq = 21.858 df = 1 ChiSq (5%) = 3.841 (association)
Gamma = 0.7407 (very strong association)

H27 Cross analysis of auditors' views about the main disadvantage of incorporation and SC audit benefits

Main disadvantage of incorporation (AQ3.3)	SC audit has significant benefit (AQ5.1) Yes	No	Total
Need for audit	34	45	79
No need for audit	51	23	74
Total	85	68	153

ChiSq = 9.344 df = 1 ChiSq (5%) = 3.841 (association)
Gamma = -0.4917 (moderate association)

H28 Cross analysis of auditors' views about the quality of their services to SC clients and SC audit requirement

Quality of accountants' services (AQ5.9)	Auditors' views in respect of SC audit requirement (AQ5.8) Not keep audit	Keep audit	Total
Deteriorate	4	16	20
Not deteriorate	82	51	133
Total	86	67	153

ChiSq = 10.621 df = 1 ChiSq (5%) = 3.841 (association)
Gamma = -0.7309 (very strong association)

H29 Cross analysis of auditors' views about the quality of their services and their clients' choice of voluntary audit if statutory audit is removed

Quality of accountants' services (AQ5.9)	% of SC clients would choose not to have a voluntary audit (AQ5.10) Less than average	More than average	Total
Improve	17	62	79
Not improve	35	39	74
Total	52	101	153

ChiSq = 10.197 df = 1 ChiSq (5%) = 3.841 (association)
Gamma = -0.5319 (substantial association)

H30 Cross analysis of auditors' views about preparation of only one set of accounts and improvement in the use of publicly filed information

Prepare only one set of accounts (AQ4.19)	One set of accounts would improve the use of publicly filed information (AQ4.20) Yes	No	Total
Yes	65	55	120
No	10	23	33
Total	75	78	153

ChiSq = 4.982 df = 1 ChiSq (5%) = 3.841 (association)
Gamma = 0.4621 (moderate association)

H31 Cross analysis of auditors' views about preparation of only one set of accounts and reduction in the burden of accounting requirements on SCs

Prepare only one set of accounts (AQ4.19)	One set of accounts would reduce the burden of accounting requirements on SCs (AQ4.20) Yes	No	Total
Yes	86	34	120
No	7	26	33
Total	93	60	153

ChiSq = 25.565 df = 1 ChiSq (5%) = 3.841 (association)
Gamma = 0.8076 (very strong association)

H32 Cross analysis of auditors' views about preparation of only one set of accounts and reduction in the associated audit effort

Prepare only one set of accounts (AQ4.19)	One set of accounts would reduce the associated audit effort (AQ4.20) Yes	No	Total
Yes	67	53	120
No	9	24	33
Total	76	77	153

ChiSq = 7.342 df = 1 ChiSq (5%) = 3.841 (association)
Gamma = 0.5424 (substantial association)

H33 Cross analysis of auditors' views about SC audit requirement and reduction in the overall costs if review substitutes SC audit

Auditors' views in respect of SC audit requirement (AQ5.8)	Review would reduce the overall costs (AQ5.4) Yes	No	Total
Not keep audit	53	33	86
Keep audit	25	42	67
Total	78	75	153

ChiSq = 7.963 df = 1 ChiSq (5%) = 3.841 (association)
Gamma = 0.4592 (moderate association)

H34 Cross analysis of auditors' views about SC audit requirement and confusion created if review substitutes SC audit

Auditors' views in respect of SC audit requirement (AQ5.8)	Review would create confusion over its nature and scope (AQ5.4) Yes	No	Total
Not keep audit	42	44	86
Keep audit	48	19	67
Total	90	63	153

ChiSq = 7.172 df = 1 ChiSq (5%) = 3.841 (association)
Gamma = -0.4515 (moderate association)

H35 Cross analysis of auditors' views about SC audit requirement and assurances provided if review replaces SC audit

Auditors' views in respect of SC audit requirement (AQ5.8)	Review would provide same assurances as audit (AQ5.4) Yes	No	Total
Not keep audit	46	40	86
Keep audit	24	43	67
Total	70	83	153

ChiSq = 4.051 df = 1 ChiSq (5%) = 3.841 (association)
Gamma = 0.3465 (moderate association)

H36 Cross analysis of auditors' practice size and their views about the main disadvantage of incorporation

	Main disadvantage of incorporation (AQ3.3)		
	Need of audit	Others	Total
Accountancy firm size (AQ2.2)			
Small (up to 5 partners)	68	56	124
Not Small	11	18	29
Total	79	74	153

ChiSq = 2.690 df = 1 ChiSq (5%) = 3.841 (no association)

H37 Cross analysis of auditors' practice size and their views about reduction in fees if no audit is performed

	Offer of a larger reduction than average in fees if no audit is performed (AQ5.10)		
	Yes	No	Total
Accountancy firm size (AQ2.2)			
Small (up to 5 partners)	66	58	124
Not Small	19	10	29
Total	85	68	153

ChiSq = 1.438 df = 1 ChiSq (5%) = 3.841 (no association)

H38 Cross analysis of auditors' practice size and their views about very SC audit requirement

	Auditors' views about very SC audit requirement (AQ5.6)		
	Not keep audit	Keep audit	Total
Accountancy firm size (AQ2.2)			
Not large	121	23	144
Large (more than 20 partners)	6	3	9
Total	127	26	153

ChiSq = 1.810 df = 1 ChiSq (5%) = 3.841 (no association)

H39 Cross analysis of auditors' practice size and their views about proprietary SC audit requirement

	Auditors' views about proprietary SC audit requirement (AQ5.7)		
	Not keep audit	Keep audit	Total
Accountancy firm size (AQ2.2)			
Not large	120	24	144
Large (more than 20 partners)	6	3	9
Total	126	27	153

ChiSq = 1.619 df = 1 ChiSq (5%) = 3.841 (no association)

H40 Cross analysis of auditors' practice size and their views about other SC audit requirement

	Auditors' views about other SC audit requirement (AQ5.8)		
	Not keep audit	Keep audit	Total
Accountancy firm size (AQ2.2)			
Not large	82	62	144
Large (more than 20 partners)	4	5	9
Total	86	67	153

ChiSq = 0.538 df = 1 ChiSq (5%) = 3.841 (no association)

H41 Cross analysis of auditors' views about the reliance of Inland Revenue on SC audited accounts and SC audit requirement

	Auditors' views in respect of SC audit requirement (AQ5.8)		
Inland Revenue place greater reliance on the audited accounts of SCs (AQ4.4)	Not keep audit	Keep audit	Total
Yes	32	36	68
No	54	31	85
Total	86	67	153

ChiSq = 3.521 df = 1 ChiSq (5%) = 3.841 (no association)

H42 Cross analysis of auditors' views about SC audit benefits and SC audit requirement

	Auditors' views in respect of SC audit requirement (AQ5.8)		
	Not keep audit	Keep audit	Total
SC audit has benefits (AQ5.1)			
Yes	45	40	85
No	41	27	68
Total	86	67	153

ChiSq = 0.830 df = 1 ChiSq (5%) = 3.841 (no association)

H43 Cross analysis of auditors' views about the main advantage of incorporation and SC audit requirement

	Auditors' views in respect of SC audit requirement (AQ5.8)		
	Not keep audit	Keep audit	Total
Main advantage of incorporation (AQ3.2)			
Limitation of liability	44	44	88
No limitation of liability	42	23	65
Total	86	67	153

ChiSq = 3.244 df = 1 ChiSq (5%) = 3.841 (no association)

H44 Cross analysis of auditors' views about the main disadvantage of incorporation and their clients' choice of voluntary audit

	% of SC clients would choose not to have a voluntary audit (AQ5.10)		
	Less than 50%	More than 50%	Total
Main disadvantage of incorporation (AQ3.3)			
Need for an audit	23	56	79
No need for an audit	29	45	74
Total	52	101	153

ChiSq = 1.729 df = 1 ChiSq (5%) = 3.841 (no association)

H45 Cross analysis of auditors' views about the main disadvantage of incorporation and SC audit requirement

Main disadvantage of incorporation (AQ3.3)	Auditors' views in respect of SC audit requirement (AQ5.8): Not keep audit	Keep audit	Total
Need for an audit	50	29	79
No need for an audit	36	38	74
Total	86	67	153

ChiSq = 3.328 df = 1 ChiSq (5%) = 3.841 (no association)

H46 Cross analysis of auditors' views about the main disadvantage of incorporation and reduction in fees if no audit is performed

Main disadvantage of incorporation (AQ3.3)	Offer of a larger reduction than average in fees if no audit is performed (AQ5.10): Yes	No	Total
Need for an audit	43	36	79
No need for an audit	42	32	74
Total	85	68	153

ChiSq = 0.084 df = 1 ChiSq (5%) = 3.841 (no association)

H47 Cross analysis of auditors' views about the main disadvantage of incorporation and the main difficulty in auditing SCs

Main disadvantage of incorporation (AQ3.3)	Main difficulty in auditing SCs (AQ5.2): Not lack of internal control	Lack of internal control	Total
Need for an audit	39	40	79
No need for an audit	38	36	74
Total	77	76	153

ChiSq = 0.060 df = 1 ChiSq (5%) = 3.841 (no association)

H48 Cross analysis of auditors' views about reductions in fees if audit requirement for SCs is abolished and its effect on their practice income

Offer of a larger reduction than average in fees if no audit is performed (AQ5.10)	Practice income (AQ5.5) Not decrease significantly	Decrease significantly	Total
No	62	6	68
Yes	75	10	85
Total	137	16	153

ChiSq = 0.349 df = 1 ChiSq (5%) = 3.841 (no association)

H49 Cross analysis of auditors' views about SC audit benefits and reduction in fees if no audit is performed

SC audit has benefits for SCs (AQ5.1)	Offer of a larger reduction than average in fees if no audit is performed (AQ5.10) Yes	No	Total
Yes	49	36	85
No	36	32	68
Total	85	68	153

ChiSq = 0.339 df = 1 ChiSq (5%) = 3.841 (no association)

H50 Cross analysis of auditors' views about SC audit benefits and their clients' choice of employing accountants if statutory audit is removed

SC audit has benefits for SCs (AQ5.1)	% of SC clients would cease to employ an accountant (AQ5.10) Less than average	More than average	Total
Yes	53	32	85
No	48	20	68
Total	101	52	153

ChiSq = 1.142 df = 1 ChiSq (5%) = 3.841 (no association)

H51 Cross analysis of auditors' views about choice of a voluntary audit and reduction in their fees if statutory audit is removed

% of SC clients would choose not to have a voluntary audit (AQ5.10)	Reduction in fees (AQ5.10) Less than average	More than average	Total
Less than average	23	29	52
More than average	45	56	101
Total	68	85	153

ChiSq = 0.001 df = 1 ChiSq (5%) = 3.841 (no association)

H52 Cross analysis of auditors' views about their time spent on SC clients and reduction in their practice income if statutory audit is removed

Time spent on SC clients (AQ6.2)	Practice income (AQ5.5) Not decrease significantly	Decrease significantly	Total
Less than average	49	2	51
More than average	88	14	102
Total	137	16	153

ChiSq = 3.490 df = 1 ChiSq (5%) = 3.841 (no association)

H53 Cross analysis of auditors' views about their time spent on SC clients and SC audit requirement

Time spent on SC clients (AQ6.2)	Auditors' views in respect of SC audit requirement (AQ5.8) Not keep audit	Keep audit	Total
Less than average	31	20	51
More than average	55	47	102
Total	86	67	153

ChiSq = 0.651 df = 1 ChiSq (5%) = 3.841 (no association)

H54 Cross analysis of auditors' views about their number of SC clients and SC audit requirement

	Auditors' views in respect of SC audit requirement(AQ5.8)		
	Not keep audit	Keep audit	Total
Number of SC clients (AQ6.2)			
Less than average	37	25	62
More than average	49	42	91
Total	86	67	153

ChiSq = 0.509 df = 1 ChiSq (5%) = 3.841 (no association)

H55 Cross analysis of auditors' views about their number of SC audit clients and SC audit requirement

	Auditors' views in respect of SC audit requirement (AQ5.8)		
	Not keep audit	Keep audit	Total
Number of SC audit clients (AQ6.2)			
Less than average	21	8	29
More than average	65	59	124
Total	86	67	153

ChiSq = 3.817 df = 1 ChiSq (5%) = 3.841 (no association)

CONTINGENCY TABLES FOR TESTING DIRECTORS' AND AUDITORS' HYPOTHESES

H56 Cross analysis of directors' and auditors' opinions about the main user of SC accounts

	Main user of SC accounts					
	Share-holders	Inland Revenue	Banks	Directors	Others	Total
Directors	13	37	30	20	6	106
Auditors	12	57	33	50	1	153
Total	25	94	63	70	7	259

ChiSq = 12.758 df = 4 ChiSq (5%) = 9.488 (association)
Gamma = 0.0857 (negligible association)

H57 Cross analysis of directors' and auditors' opinions about profit before tax as the most important financial indicator for business decisions in SC accounts

	Most important financial indicator for business decisions		
	Profit before tax	Not profit before tax	Total
Directors	30	76	106
Auditors	70	83	153
Total	100	159	259

ChiSq = 7.325 df = 1 ChiSq (5%) = 3.841 (association)
Gamma = -0.3624 (moderate association)

H58 Cross analysis of directors' and auditors' opinions about whether SC full accounts are intrusive into the owner's private affairs

	Full accounts of SCs are intrusive into the owner's private affairs		
	Yes	No	Total
Directors	23	83	106
Auditors	15	138	153
Total	38	221	259

ChiSq = 6.158 df = 1 ChiSq (5%) = 3.841 (association)
Gamma = 0.4365 (moderate association)

H59 Cross analysis of directors' and auditors' opinions about the important services provided by SCs' accountants

	Important services provided by SCs' accountants				
	Preparation of accounts	Tax advice	Audit of accounts	Others	Total
Directors	33	36	24	13	106
Auditors	82	41	5	25	153
Total	115	77	29	38	259

ChiSq = 29.896 df = 3 ChiSq (5%) = 7.815 (association)
Gamma = -0.3058 (moderate association)

H60 Cross analysis of directors' and auditors' opinions about the usefulness of SC abbreviated accounts for investment decisions

	Abbreviated accounts of SCs are useful for investment decisions		
	Yes	No	Total
Directors	22	84	106
Auditors	11	142	153
Total	33	226	259

ChiSq = 9.180 df = 1 ChiSq (5%) = 3.841 (association)
Gamma = 0.5435 (substantial association)

H61 Cross analysis of directors' and auditors' opinions about the usefulness of SC abbreviated accounts for business decisions

	Abbreviated accounts of SCs are useful for business decisions		
	Yes	No	Total
Directors	31	75	106
Auditors	17	136	153
Total	48	211	259

ChiSq = 12.464 df = 1 ChiSq (5%) = 3.841 (association)
Gamma = 0.5356 (substantial association)

H62 Cross analysis of directors' and auditors' opinions about SCs choice of voluntary audit if SC audit is abolished

	SCs would choose to have voluntary audit if SC audit is abolished		
	Yes	No	Total
Directors	60	46	106
Auditors	60	93	153
Total	120	139	259

ChiSq = 6.931 df = 1 ChiSq (5%) = 3.841 (association)
Gamma = 0.3381 (moderate association)

H63 Cross analysis of directors' and auditors' opinions about the main benefit from SC audit

	Main benefit from SC audit				
	Supporting tax	Efficient management	Supporting bank borrowing	No significant advantage	Total
Directors	30	21	32	23	106
Auditors	40	12	33	68	153
Total	70	33	65	91	259

ChiSq = 18.222 df = 3 ChiSq (5%) = 7.815 (association)
Gamma = 0.2658 (low association)

H64 Cross analysis of directors' and auditors' opinions about statutory review to replace SC audit

	Statutory review to replace SC audit		
	Yes	No	Total
Directors	17	89	106
Auditors	51	102	153
Total	68	191	259

ChiSq = 8.802 df = 1 ChiSq (5%) = 3.841 (association)
Gamma = -0.4472 (moderate association)

H65 Cross analysis of directors' and auditors' opinions about the main advantage of incorporation

Main advantage of incorporation

	Tax saving	Limitation of liability	Raise finance	Transfer of ownership	Others	Total
Directors	15	57	10	11	13	106
Auditors	19	90	14	20	10	153
Total	34	147	24	31	23	259

ChiSq = 3.124 df = 4 ChiSq (5%) = 9.488 (no association)

H66 Cross analysis of directors' and auditors' opinions about the main disadvantage of incorporation

Main disadvantage of incorporation

	Tax problem	Disclosure of financial information	Need for audit	Government form filling	Others	Total
Directors	10	14	53	25	4	106
Auditors	20	20	79	30	4	153
Total	30	34	132	55	8	259

ChiSq = 1.488 df = 4 ChiSq (5%) = 9.488 (no association)

H67 Cross analysis of directors' and auditors' opinions about the main items in SC accounts which are important for the Inland Revenue's examination of tax computations

Main items in SC accounts used by the Inland Revenue for checking tax computations

	Profit and loss account items	Not profit and loss account items	Total
Directors	75	31	106
Auditors	122	31	153
Total	197	62	259

ChiSq = 2.776 df = 1 ChiSq (5%) = 3.841 (no association)

H68 Cross analysis of directors' and auditors' opinions about the public disclosure of profit before tax in SC accounts

	Profit before tax should be publicly disclosed in SC accounts		
	Yes	No	Total
Directors	78	28	106
Auditors	117	36	153
Total	195	64	259

ChiSq = 0.280 df = 1 ChiSq (5%) = 3.841 (no association)

H69 Cross analysis of directors' and auditors' opinions about the usefulness of SC full accounts for shareholders

	Full accounts of SCs are useful for shareholders		
	Yes	No	Total
Directors	38	68	106
Auditors	67	86	153
Total	105	154	259

ChiSq = 1.638 df = 1 ChiSq (5%) = 3.841 (no association)

H70 Cross analysis of directors' and auditors' opinions about whether SC full accounts are a waste of time and money

	Full accounts of SCs are a waste of time and money		
	Yes	No	Total
Directors	60	46	106
Auditors	76	77	153
Total	136	123	259

ChiSq = 1.206 df = 1 ChiSq (5%) = 3.841 (no association)

H71 Cross analysis of directors' and auditors' opinions about the cost of producing the full accounts

	The cost of producing the full accounts outweighs the benefits derived from them		
	Yes	No	Total
Directors	53	53	106
Auditors	75	78	153
Total	128	131	259

ChiSq = 0.024 df = 1 ChiSq (5%) = 3.841 (no association)

H72 Cross analysis of directors' and auditors' opinions about the need to make accounts more useful to users

	Need to make accounts more useful to users, even if the cost of preparing the information is higher		
	Yes	No	Total
Directors	32	74	106
Auditors	41	112	153
Total	73	186	259

ChiSq = 0.356 df = 1 ChiSq (5%) = 3.841 (no association)

H73 Cross analysis of directors' and auditors' opinions about the contents of SC full accounts as compared with large company's accounts

	SCs to prepare full accounts containing almost the same information as the accounts of large companies		
	Yes	No	Total
Directors	19	87	106
Auditors	39	114	153
Total	58	201	259

ChiSq = 2.062 df = 1 ChiSq (5%) = 3.841 (no association)

H74 Cross analysis of directors' and auditors' opinions about the usefulness of SC abbreviated accounts for the public

	Abbreviated accounts of SCs are useful for the public		
	Yes	No	Total
Directors	19	87	106
Auditors	23	130	153
Total	42	217	259

ChiSq = 0.385 df = 1 ChiSq (5%) = 3.841 (no association)

H75 Cross analysis of directors' and auditors' opinions about whether SC abbreviated accounts are a waste of time and money

	Abbreviated accounts of SCs are a waste of time and money		
	Yes	No	Total
Directors	52	54	106
Auditors	90	63	153
Total	142	117	259

ChiSq = 2.412 df = 1 ChiSq (5%) = 3.841 (no association)

H76 Cross analysis of directors' and auditors' opinions about the preparation of only one set of accounts

	One set of accounts should be prepared both for shareholders of SCs and public filing		
	Yes	No	Total
Directors	82	24	106
Auditors	120	33	153
Total	202	57	259

ChiSq = 0.042 df = 1 ChiSq (5%) = 3.841 (no association)

H77 Cross analysis of directors' and auditors' opinions about the improvement in the use of publicly filed information if only one set of accounts is prepared

	One set of accounts would improve the use of publicly filed information		
	Yes	No	Total
Directors	47	59	106
Auditors	75	78	153
Total	122	137	259

ChiSq = 0.550 df = 1 ChiSq (5%) = 3.841 (no association)

H78 Cross analysis of directors' and auditors' opinions about the reduction in the burden of accounting requirements on SCs if only one set of accounts is prepared

	One set of accounts would reduce the burden of accounting requirements on SCs		
	Yes	No	Total
Directors	74	32	106
Auditors	93	60	153
Total	167	92	259

ChiSq = 2.228 df = 1 ChiSq (5%) = 3.841 (no association)

H79 Cross analysis of directors' and auditors' opinions about the reduction in the associated audit effort if only one set of accounts is prepared

	One set of accounts would reduce the associated audit effort		
	Yes	No	Total
Directors	59	47	106
Auditors	76	77	153
Total	135	124	259

ChiSq = 0.899 df = 1 ChiSq (5%) = 3.841 (no association)

H80 Cross analysis of directors' and auditors' opinions about SC audit requirement

	Attitudes to SC audit requirement		
	Keep audit	Not keep audit	Total
Directors	35	71	106
Auditors	67	86	153
Total	102	157	259

ChiSq = 3.044 df = 1 ChiSq (5%) = 3.841 (no association)

H81 Cross analysis of directors' and auditors' opinions about the effect of replacing SC audit with statutory review

	Statutory review would create confusion over its nature and scope		
	Yes	No	Total
Directors	59	47	106
Auditors	90	63	153
Total	149	110	259

ChiSq = 0.256 df = 1 ChiSq (5%) = 3.841 (no association)

H82 Cross analysis of directors' and auditors' opinions about the effect of replacing SC audit with statutory review

	Statutory review would reduce the overall costs		
	Yes	No	Total
Directors	48	58	106
Auditors	78	75	153
Total	126	133	259

ChiSq = 0.814 df = 1 ChiSq (5%) = 3.841 (no association)

H83 Cross analysis of directors' and auditors' opinions about the effect of replacing SC audit with statutory review

	Statutory review would provide almost the same assurances as audit		
	Yes	No	Total
Directors	50	56	106
Auditors	70	83	153
Total	120	139	259

ChiSq = 0.051 df = 1 ChiSq (5%) = 3.841 (no association)

ADDITIONAL CONTINGENCY TABLES FOR TESTING DIRECTORS' HYPOTHESES

H84 Cross analysis of directors' views about SC audit requirement and their number of directors and employees

	Directors' company size (DQ2.4 & DQ2.5)		
	Up to 2 directors & 5 employees	More than 2 directors & 5 employees	Total
Directors' views in respect of audit requirement (DQ4.4)			
Keep audit	5	30	35
Remove audit	30	41	71
Total	35	71	106

ChiSq = 7.075 df = 1 ChiSq (5%) = 3.841 (association)
Gamma = -0.6290 (Substantial association)

H85 Cross analysis of directors' views about SC audit requirement and their number of directors and annual turnover amount

	Directors' company size (DQ2.4 & DQ2.6)		
	Up to 2 directors & £1m turnover	More than 2 directors & £1m turnover	Total
Directors' views in respect of audit requirement (DQ4.4)			
Keep audit	5	30	35
Remove audit	37	34	71
Total	42	64	106

ChiSq = 12.485 df = 1 ChiSq (5%) = 3.841 (association)
Gamma = -0.7344 (Very strong association)

H86 Cross analysis of directors' views about SC audit requirement and their number of employees and annual turnover amount

Directors' views in respect of audit requirement (DQ4.4)	Directors' company size (DQ2.5 & DQ2.6): Up to 5 employees & £1m turnover	More than 5 employees & £1m turnover	Total
Keep audit	7	28	35
Remove audit	37	34	71
Total	44	62	106

ChiSq = 8.679 df = 1 ChiSq (5%) = 3.841 (association)
Gamma = -0.6264 (Substantial association)

H87 Cross analysis of directors' views about SC audit requirement and their number of directors, employees and annual turnover amount

Directors' views in respect of audit requirement (DQ4.4)	Directors' company size (DQ2.4, DQ2.5 & DQ2.6): Up to 2 directors, 5 employees & £1m turnover	More than 2 directors, 5 employees & £1m turnover	Total
Keep audit	3	32	35
Remove audit	28	43	71
Total	31	75	106

ChiSq = 9.353 df = 1 ChiSq (5%) = 3.841 (association)
Gamma = -0.7483 (Very strong association)

CHAPTER 11

SUMMARY, CONCLUSIONS AND RECOMMENDATIONS

11.1 Introduction

This Chapter provides a summary of the main issues investigated, the limitations, and the main findings of the research.

Furthermore, it provides the main recommendations derived from the research and the areas requiring further research.

11.2 Areas of investigation

The main objective of this research was to investigate whether there is a need for change in the accounting and audit requirements of small private companies based on recent developments and selected group (directors and auditors of SCs) perceptions.

In order to achieve the research objective, the following areas were investigated.

a) A comprehensive literature review of SCFR was carried out in the following four areas in order:

   i) to establish a rationale for auditing within a coherent theoretical framework and to investigate whether the SC audit debate can be placed within the context of a generally accepted framework for company auditing in order to put various arguments in perspective;

ii) to identify the role played by the major parties in the SCFR debate;

iii) to identify the important issues in a SC environment which affect SCFR; and

iv) to consider the SCFR debate in detail.

b) A review of a sample of SC accounts was undertaken to check whether disclosure was consistent with various financial reporting requirements (CA, auditing and accounting standards) and also to assess the appropriateness of current reporting requirements for SCs (survey of accounts).

c) Postal questionnaires were used to ascertain the views of the directors and auditors of SCs about SCFR issues (surveys of directors and auditors).

d) Cross analysis of results was undertaken in order to provide some assurances about the consistency of the primary findings of the surveys and also to identify the diversity of opinions among the directors and auditors.

Before considering the findings of the above investigations, it is important to consider the limitations of the research which may weaken the validity of some of the findings.

11.3 Limitations of the research

The main limitations of the research were in respect of:

Use of questionnaire

The main problem of a questionnaire survey is non-response. To deal with this problem, it has been assumed that, it is likely that the non-respondents are closer in their characteristics to those who responded to the follow-up questionnaire than to the initial questionnaire. This assumption is dubious.

Despite the general lack of bias detected when testing non-response bias, the effect of the above assumption remains. Furthermore, there are other disadvantages to the questionnaire survey (Moser & Kalton, 1971), for example:

- differences in interpretation might go undetected;

- respondents might simply guess an answer; and

- too many choices might produce errors by respondents.

Statistical tests

Chi-square tests of independence were used on the assumption that the distribution of the data collected through the questionnaires did not exhibit the characteristics of a normal distribution and the frequency counts were independent of one another; also, the expected frequency in all cells was equal to or greater than 5 in the one-degree-of-freedom situation.

Small user groups

For pragmatic consideration, the research was restricted to ascertain the views of only two selected groups (i.e. directors and auditors) about SCFR. Therefore, the findings represent only limited views of the SCFR and are not applicable to other user groups.

Specific SCFR issues

This research cannot be construed as an examination of all the issues in SCFR as it was restricted to the examination of only the main SCFR issues.

11.4 The main findings of the research and their significance

11.4.1 The main findings of the literature review under four main areas of investigation

SC audit: a theoretical framework

The literature review indicated that there are two main types of approach adopted to establish a rationale for auditing within a coherent theoretical framework, namely: postulates and economic approach. Basically, the postulates approach is concerned with operationalising the audit process given its existence, and it helps to construct basic assumptions which are implicit in auditing. The economic approach, on the other hand, attempts to explain the demand for and supply of audit services. In particular, agency theory which deals with the problem of the separation of ownership and control of the firm by both shareholders and managers, argues that shareholders may be able to maximise their wealth by using incentive compensation contracts together with independent monitoring of the financial reporting. In this regard, it is worth pointing out that according to agency theory the need for a monitoring service does not necessarily come from shareholders. Indeed, it has been demonstrated that the need for the audit may come from the agent (see for example, Evans, 1980). Within the economic approach, other theories such as information theory, insurance theory, signalling theory and behavioural theory also provide interesting explanations for the need for audit.

Furthermore, in contracting theory (within the economic approach), auditing and accounting are related and the use of accounting in contract requires monitoring. Contracting theory also provides some explanations as to why auditors may be concerned with their independence and reputation, the development of professional societies, large firms and the organisational form adopted by audit firms.

According to Robertson (1986b) there has been no application of a theoretical framework for analysis of the SC audit problem. Without reference to a theoretical framework, it is difficult to put the various arguments in perspective and, therefore, there is no rational or consistent means of evaluating alternative solutions.

A review of the arguments against the SC audit requirement indicates that there are a number of weaknesses in the assumptions on which company auditing theory is built as far as SCs are concerned. In this regard, Robertson (1986b) argues that if these assumptions appear to be absurd in a SC context, then existing practice is in some way incompatible with existing aims and objectives. As a possible solution, he suggests the following options for reconciling these in a SC context:

i) change practice in order to become consistent with the existing aims and objectives; or

ii) change the existing aims and objectives to achieve what is feasible and agreeable in practice in a SC environment.

According to Robertson (1986b:54):

> "Whichever route is chosen, it seems clear that it is agreement which holds the key to future progress -

agreement as to the purpose and uses of small company financial statements, and agreement as to what is and is not feasible in a small company context".

The role played by the main parties in the SCFR debate

In general, the regulatory bodies (e.g. DTI, ASB and APB) appear to be more concerned with the financial reporting of large public companies. However, the DTI as a result of pressure from the professional bodies in August 1994 exempted certain SCs from statutory audit requirement, and more recently there have been further proposals by the regulatory bodies to free SCs from the unnecessary burden of some aspects of their financial reporting requirements, for example, to simplify the form and content of their accounts (DTI, 1995).

With reference to the role played by each of the major professional institutions (e.g. ICAEW, ICAS and ACCA) in the SCFR debate, this appears to be determined to some extent by the membership they serve, although it has been suggested that "they now have considerably more power over their members...". (See "A waste of time?", Accountancy, March 1994:15).

It is evident from responses to the discussion papers (ICAEW, 1993; DTI, 1993) that accountancy firms of all sizes appear to be interested in the SCFR debate. This is more evident than before as accountancy firms now face increased competition from each other and from unqualified accountants for Very SC clients.

With regard to other major parties (e.g. banks and tax authorities) who are among the main users of SC accounts, it appears that they use their influence and, in the case of tax authorities, their statutory right to obtain the required information from SCs. But, it has been observed that banks may not always be successful in this regard.

As far as SCs themselves are concerned, it is evident from responses to the discussion papers (APC, 1979 and ICAEW, 1993) that SCs in general and owner-managed SCs in particular are, generally speaking, not interested in participating in the SCFR debate as they do not perceive any benefit from their financial reporting requirement.

The important issues in a SC environment which affect SCFR.

The major findings relating to this aspect of literature review broadly indicate that:

* most definitions of a SC overlap greatly and SCs comprise the vast majority of UK companies;

* SCs have specific characteristics and the approach to the SC audit needs to be responsive to these characteristics; and there are "statistically significant" relationships between some SC characteristics and SC auditing problems;

* the majority of SCs are owner-managed;

* it is possible to carry out an efficient and effective audit of SCs in many situations;

* compliance costs of accounting standards are relatively higher for SCs and their benefits are relatively lower;

* there is a defined group of users of SC accounts with different kinds of needs;

* SCs' auditors often provide a wide range of services, which may increase the auditors' power in dealing with SC clients without conflict of interest with

management;

* in addition to the reduction in the detailed disclosure requirements in accounts of members of SCs (SI 1992, No. 2452), there are proposals for further simplification of the form and content of SC accounts (DTI, 1995); and

* not many overseas countries appear to require their SCs to be audited, bearing in mind that they have different definitions of SCs which may make any international comparisons rather difficult.

SCFR debate

SCs as defined by the CA 1985 may file abbreviated accounts with the Registrar of Companies but they must prepare and circulate full accounts to their shareholders. All SCs' accounts had been subject to statutory audit until recently when certain SCs were exempt from audit. The form and content of these accounts and their need for a statutory audit have been subject to debate for a long time.

As companies expand, the greater will be the tendency for shareholders to become divorced from their affairs and therefore, the greater will become their needs for <u>reliable</u> financial information about their companies' activities, performance and financial affairs. It is this structure of the company, with ownership often divorced from management, which may justify the audit requirement.

However, in many SCs, where owner-managers normally participate in the day-to-day activity of the company and have a good knowledge of their company's financial performance, the <u>need for audit is debatable</u>.

Many arguments have been put forward in favour and against SC audit requirement which have been considered in Chapter 5 (e.g. APC, 1979; ICAEW, 1992b). These arguments are mainly based on the value of the audit to those who have an interest in SC affairs (e.g. shareholders, banks, tax authorities, management and trade creditors) and they indicate that substantive benefit is in the provision of the accounts and the audit provides additional assurance as to the truth and fairness of the information.

However, evidence from the current surveys (DTI, 1993) indicates that the audit of SCs is an unnecessary burden even when viewed on a cost-benefit basis, both to the company and to the wider economy (ICAEW, 1992b).

The opportunity cost of diverting management time to deal with audit matters is likely to be proportionately higher for smaller companies than larger companies and, together with the extra cost of the new audit regulation has contributed to an increase in costs compared with audit benefits for SCs in general and owner-managed private companies in particular.

In March 1993, analysis of responses to the ICAEW (1992b)'s consultation paper confirmed that the majority of respondents were in favour of relaxing SC audit requirement in some way.

The options available for replacing SC audit have been considered by the DTI (1988). Of those options, two were considered to be more relevant for the SCFR; these are a compilation report and a statutory review. The compilation approach is similar to that currently carried out by practitioners in relation to the accounts of unincorporated businesses. The compilation report gives no assurance as to whether the accounts give a "true and fair" view and the only comfort to the users of the accounts is the fact that the accounts have been prepared with due professional skill and care.

On the other hand, a statutory review provides limited assurance on the validity of the accounts (DTI, 1988) and would be little different to the present SC audit, thus the review cost would be similar to that presently incurred in an audit and higher than the compilation option.

In order to decide to which sub-categories of SCs the above options may apply, the VAT thresholds have been used for defining these, based on the companies' annual turnover limit as they already have significant implications for the way in which a company conducts its business and they can easily be reviewed and upgraded.

The application of SC audit alternatives to some categories of SCs have been considered by various discussion papers (e.g. DTI, 1988; ICAEW, 1992b; LSCA, 1992 and DTI, 1993). In the November 1993 Budget, the Chancellor of the Exchequer announced the relaxation of the audit requirement for certain categories of SCs. The possible consequences of these changes, which came into force on 11 August 1994, are briefly considered below:

* in Very SCs, the owner-managers may benefit from audit exemption by spending the saving on further business advice. However, the level of saving is unlikely to be as high as claimed;

* lack of audit may lead to inadequate financial discipline which can contribute towards SC failure;

* the quality of filed accounts is expected to deteriorate, which may result in loss of confidence to

the general public who use these accounts for business decisions;

* the risk of fraud and error would probably increase;

* the level of competition among accountancy firms may be intensified, which may result in some smaller firms merging in order to offer a better range of services. This may also lead to deregistration by auditors, who have many Very SC clients. However, as some surveys have shown, few auditors are likely to deregister; and

* the company's creditors and other stakeholders are likely to suffer because they will be able to derive less assurance from the accounts with which they are presented.

Overall, it appears that the government's drive to free SCs from unnecessary burdens is in the right direction but whether the proposed solutions are acceptable in practice is yet to be seen.

This research has been a contribution in the above direction and its findings are summarised below.

11.4.2 The main findings of the survey of accounts

The main findings of the survey of accounts broadly indicate, within the context of the sample companies which were considered to be relatively "smaller" than "average", that:

* There is an apparent improvement in filing of accounts by the companies. This is based on comparing the result of this survey, which indicated that 19% of the sample companies were late in filing their accounts with those of leading studies such as Page (1981)

(26%) and Robertson (1986a) (30%);

* The stewardship principle of reporting by directors to shareholders does not seem to be appropriate in many SCs where the directors are the main shareholders, for example in 71% of the sample companies, directors were reporting to themselves as the only shareholders;

* Comparing the total number of qualified audit reports in this survey (20%) with those of Carsberg et al (1985) (32%) and Robertson (1986a) (44%), it appears that there had been a fall in the number of qualified audit reports;

* Perhaps due to the additional costs of preparing abbreviated accounts, many SCs do not take advantage of this option. For example, the survey of accounts indicated that only 35% of the sample companies which were entitled to file abbreviated accounts availed themselves of the option; and

* The extent of non-compliance with certain financial reporting requirements did not appear to be widespread.

11.4.3 The main findings of surveys of directors and auditors

The findings of the surveys of directors and auditors and their significance are presented in detail in Chapters 8 and 9 respectively and are not reproduced here. However, the main similarities and differences between the findings of both surveys and the extent of diversity of opinion among directors and auditors are considered below. In comparing the surveys' results, it is worth noting that the sample directors came from companies which were considered to be "bigger" than "average" in terms of turnover (sales) and employment distributions and with "greater" ownership (and control) of their companies than "average". On the other hand, the sample auditors came from audit firms which were considered to be "smaller" than "average" in terms of number of partners and professional staff distributions (see section 6.3). A number of broad conclusions may be drawn from these surveys:

a) The main <u>similarities</u> between the findings of the surveys of directors and auditors

* The ownership and control of SCs are highly concentrated in the hands of the directors and their families. The significance of this finding is that the main reporting should be for directors and some safeguards are needed for minority shareholders not involved in management.

* The limitation of liability was considered to be the most important advantage of incorporation. This is despite the fact that in SCs, directors usually have to provide personal guarantees to secure the company's borrowing.

* The need for an audit was considered to be the main disadvantage of incorporation.

* "Tax authorities" were considered to be the most important user of the annual accounts of SCs (or "supporting tax computation" was considered to be the most important use of annual accounts by SCs). It emerged from these surveys that low priority had been given to use of the accounts by the companies' directors, contrary to earlier findings (Page, 1981).

* Profit before tax, net current assets and turnover

(if stated), contained in the published annual accounts of private companies, were considered to be important financial factors for making business decisions.

* The majority of the respondents claimed that both abbreviated and full accounts of SCs were a waste of time and money and were not useful for shareholders or the public.

* In considering simplification of the form and content of SC accounts, the overwhelming majority of the respondents supported the view that only one set of accounts should be prepared both for the shareholders of SCs and filing with the Registrar of Companies. Furthermore, with reference to the perceived benefits of this simplified form of accounts, the majority of respondents claimed it would reduce both the burden of accounting requirements on SCs and the associated audit effort. With respect to the possible content of "one set of accounts", the majority of the respondents supported in particular the inclusion of a shortened profit and loss account, with possible disclosure of "turnover" and "profit before tax".

* The audit report and the auditors' reputation were not considered to be very important when banks or the Inland Revenue examine the SC's annual accounts.

* Both groups of respondents supported relaxation of the SC audit requirement in some way.

* The majority of the respondents did not support the replacement of an audit with a statutory review,

because they claimed that a statutory review would create confusion over its nature and scope as compared with an audit, and that it would not provide the same assurances as an audit.

b) The main <u>differences</u> between the findings of the surveys of directors and auditors

* The majority (54%) of the sample auditors considered "preparation of accounts" the most important service provided to their clients. However, the highest proportion (34%) of the sample directors considered "tax advice" the most important service provided by their accountants, probably due to tax savings generated as a result of both corporation and personal tax planning.

* Furthermore, more directors (23%) than auditors (3%) considered "audit of accounts" the most important service provided by SC accountants and also fewer directors (20%) than auditors (39%) considered there was no significant benefit to SCs from having an annual audit. These findings may indicate that the SC audit requirement has more support among the sample directors than auditors. This is further supported by another finding that if the statutory audit requirement for SCs was removed, the majority of directors (56%) (as against 39% estimated by auditors) would choose to have a voluntary audit. These findings may indicate a lack of understanding of the auditor's role by the sample directors and/or a lack of understanding by auditors of the services required by directors, bearing in mind that the sample directors and auditors came from organisations which were considered to be relatively "bigger" and "smaller" than "average" respectively.

It should be noted that the following specific findings relate to the questions which were asked only in the auditors' questionnaire because of their technical nature. Accordingly, these findings should not be considered the main differences between the findings of the two surveys:

* The majority of the sample auditors claimed that the current CA requirements were unnecessarily complex and burdensome for SCs, and that the audit regulation had resulted in extra costs to auditors which were passed on to their audit clients. In addition, the majority of auditors supported the introduction of separate auditing and accounting standards for SCs.

* Lack of internal control, stock valuation and understatement of sales were claimed to be the main areas of difficulties in auditing SCs.

* According to the majority of auditors the withdrawal of the old "example 6" audit report had not helped them in their reporting.

c) Identification of groups of attitudes among directors and auditors

Cross analysis of the results provided some assurances of the consistency of the primary findings reported in Chapters 8 and 9. In addition, significant associations were identified between groups of attitudes. For example, the directors of SCs having up to 2 directors and 5 employees and £1m annual turnover tended to be more in favour of abolition of the SC audit.

On the other hand, for example, auditors from smaller firms (having up to 5 partners) tended to consider that an audit had significant benefit to their SC clients. These associations may be considered useful in identifying the diversity of opinion among the sample directors and auditors about certain SCFR issues.

It is noteworthy that in addition to the above, the cross analysis of results indicated, for example, that a higher proportion of the sample directors than of the auditors considered SC audit a valuable service.

11.4.4 The extent of changes in directors' and auditors' opinions over the last decade

Comparison of the main findings of this research and Page (1981) indicates the extent of changes (or otherwise) in directors' and auditors' opinions over the last decade. In comparing these results, the effects of sample sizes should be borne in mind and, as indicated earlier, the sample directors and auditors of this study came from organisations which were considered to be "bigger" and "smaller" than "average" respectively.

In particular, the comparative analysis (see section 6.3, survey of auditors) indicated that this research sample might have a slightly higher number of "smaller" audit firms (up to 5 partners) than probably those of Page (1981), although a strict comparison was not possible.

a) Ownership and control of SCs

The findings of the surveys of directors and auditors relating to the percentage of shareholdings held by directors and their families are comparable with those of Page (1981) in a survey of annual returns and accounts of SCs. These findings indicate that despite changes in the business environment and company law, the control of SCs continues to be in the hands of the directors.

b) Main advantages of incorporation

Table 11.1: Comparisons of the main advantages of incorporation with Page (1981)'s surveys

	These surveys		Page (1981)'s surveys	
	Dir. %	Aud. %	Dir. %	Aud. %
Limitation of liability	54	59	46	70
Tax saving	14	13	16	18

Limitation of liability was considered in both surveys of this research and also those of Page (1981)'s research to be the most important advantage of incorporation. In fact, comparing the findings of the directors' surveys of both research studies may indicate that the importance of limitation of liability to directors is higher now (54%) than a decade ago (46%), perhaps partly due to lesser importance of "tax saving" now. On the other hand, it appears that the benefits of limitation of liability have been to some extent eroded as far as auditors are concerned.

c) Main disadvantages of incorporation

Table 11.2: Comparisons of the main disadvantages of incorporation with Page (1981)'s surveys

	These surveys		Page (1981)'s surveys	
	Dir. %	Aud. %	Dir. %	Aud. %
Need for an audit	50	52	12	32
Government form filling	24	20	44	24

Comparison between the findings of the directors' surveys of both research studies indicate that there is a significant increase (from 12% in Page's survey to 50% now) in the percentage of directors who considered the "need for an audit" to be the main disadvantage of incorporation. This might be due to an increase in the cost of an audit as a result of the audit regulation introduced by the CA 1989.

Furthermore, in Page (1981)'s survey, "Government form filling" (44%) had been considered the main disadvantage of incorporation a decade ago. However, since the publication of the "Burden on Business" report (DTI, 1985a) there have been substantial reductions in the demand for information from SCs resulting in less "Government form filling".

d) Main use of SC accounts

Table 11.3: Comparisons of the main use of SC accounts with Page (1981)'s surveys

	These surveys		Page (1981)'s surveys	
	Dir. %	Aud. %	Dir. %	Aud. %
Supporting tax computations	35	37	26	33
Providing information to banks and loan creditors	28	22	17	13
Providing information to management	19	33	41	46

"Supporting tax computations" was found in both surveys in this research to be the most important use of SC accounts. However, a decade ago, "providing information to management" was found by both surveys of Page (1981) to be the most important use of SC accounts.

This is an interesting finding as it indicates that the annual accounts are used by management less than before, probably reflecting an increasing use of management accounts. In fact, 66% of the sample directors confirmed that their decisions are based on management information rather than full annual accounts. The discrepancy between these results is probably explained by differences in the size profiles of the sample companies; as the sample companies of this study was considered "bigger" than "average", probably with greater demand for up-to-date information, which managements accounts are believed to provide. The delay in producing annual accounts is believed to severely limit their use.

11.4.5 Directors' and auditors' attitudes to possible change of audit requirement for SCs

The majority of the sample directors (51%) claimed to be against the audit requirement for SCs. In their questionnaire, no distinction was made between different sub-categories of SCs (i.e. Very SCs, Proprietary SCs and Other SCs) as the finding from the pilot study had already indicated that directors in general could not recognise their differences.

The auditors' survey ascertained the sample auditors' attitudes to possible change of the audit requirement for different categories of SCs and their possible effects, which provided interesting results.

With reference to the audit requirement, the majority of auditors (83%) claimed that it should be abolished for Very SCs. Furthermore, in response to two separate questions in this regard, the highest proportion of auditors claimed that the audit requirement for Proprietary companies should be substituted with a review carried out by an independent and qualified accountant and that the audit requirement for all other private SCs should be retained.

With regard to the possible effects of SC audit abolition, the majority of auditors estimated that their income would at least stay much the same and the quality of their services to SC clients would improve.

11.4.6 Comparison of the research findings with the recent statutory SCFR requirements

The new statutory SCFR requirements which came into force on 11 August 1994 abolished the audit requirement for companies with turnover up to £90,000 p.a. and replaced the audit requirement for companies with a turnover between £90,000 and £350,000 p.a. (and balance sheet total not exceeding £1.4m) with a compilation report. No changes were made for other SCs. In general, the main difference between the recent requirements and the findings of this research (apart from turnover limits for SCs) is in respect of choosing between a <u>compilation report</u> or a <u>review</u>.

There was no great support for the compilation report in the survey of auditors. This might be due to the fact that a compilation report gives no assurance as to whether annual accounts give a "true and fair" view. Furthermore, the quality of filed accounts and financial discipline are expected to deteriorate under the compilation report option, resulting in loss of confidence by the main users of SC accounts and an increase in the number of SC failures. Perhaps, with these in mind, the highest proportion (44%) of the auditors thought that the audit requirement for "proprietary" companies should be substituted with a <u>review</u>, probably because a review is thought to provide a limited assurance on the validity of the accounts.

11.4.7 The implication of the research findings for the theoretical framework for SC auditing

The main findings of this research, which are based on some form of consensus among directors and auditors of SCs, call for simplification of the form and content of SC accounts and the relaxation of the audit requirement for some SCs.

The implication of these findings for the theoretical framework for company auditing is that the existing audit requirement ("aims and objectives") is no longer justified for all SCs. Accordingly, there is a need to "change the existing aims and objectives to achieve what is feasible and agreeable in practice" for certain SCs. The following recommendations are a contribution in this direction.

11.5 Recommendations

A summary of the main recommendations derived from the research findings, which may have some implication for policy makers in this field, is presented below:

a) SC accounts

i) Only one set of accounts should be prepared for both shareholders of SCs and public filing.

ii) The proposed one set of accounts should include a shortened directors' report, a report of the accountants/auditors, a shortened profit and loss account (including turnover and profit before tax figures) and a full balance sheet and related notes to the accounts including movements on shareholders' funds reconciliation.

iii) The proposed one set of accounts should apply to all SCs or at least to small owner-managed companies.

b) SC audit requirement

i) The audit requirement for Very SCs should be abolished, subject to protection of minority shareholders who can demand an audit. It is interesting to note that this requirement came into force in August 1994, while this research was being undertaken.

ii) The audit requirement for Proprietary SCs (i.e. effectively owner-managed companies) should be substituted with a review carried out by an independent and qualified accountant. Review would provide a limited assurance.

iii) The audit requirement for other SCs should be retained.

11.6 Further research

The limitations of this research could offer opportunities for additional research in this area. For example, the need

i) to ascertain the views of other user groups (e.g. banks) about SCFR; and/or

ii) to investigate other aspects of SCFR issues (e.g. the appropriateness of different forms of reporting - compilation report and review).

It is hoped that the recommendations of the research could also offer some further investigation as to:

i) the appropriateness of one set of accounts; and

ii) the effects of replacing an audit with a review for proprietary SCs.

Finally, there is a need for empirical research to investigate the effects of the new SCFR requirements (which came into force in August 1994) on a cost/benefit basis, to establish whether they satisfy the needs of the different user groups and if not, how the existing aims and objectives should be further changed in order to achieve what is feasible and agreeable in practice in a SC environment.

n EC2A 4NB
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APPENDIX 1

LSCA'S COVERING LETTER

SENT WITH THE QUESTIONNAIRES

LSCA
LONDON SOCIETY OF
CHARTERED ACCOUNTANTS

Ref: lp\forms-1.kt

Dear Member

You were invited to attend the recent seminar on "The Future of the Small Company Audit". A lively debate was developed which I hope you enjoyed if your attended the meeting.

Following the meeting, and to gain further opinion to present to the Institute, I enclose a questionnaire which I hope you will complete and return as soon as possible.

The form has been designed in collaboration with a student at City University Business School who will help us summarise the information from the responses. Such a summary will form the basis of an article in Capital Account and give further weight to the LSCA's response to the Institute's paper FRAG 21.

We would value your participation in this exercise which should only take you a few minutes to complete and must be of specific interest to your future business. There is included a form designed to be completed by one of your limited company clients to give us another area of opinion. Both the questionnaires are completely confidential and no further use will be made of the data base produced from the respondents to the seminar after this occasion.

Please help us in this instance to respond to the Institute with a significant weight of opinion which will undoubtedly influence any pronouncement to be made on this issue.

Stamped addressed envelopes are attached for you and your clients replies. All we ask is a few minutes of your time.

Yours faithfully

John H. Bowen FCA FCT
Secretary - London Practitioner Board

APPENDIX 2

QUESTIONNAIRE FOR DIRECTORS & SHAREHOLDERS OF THE ACTIVE, INDEPENDENT PRIVATE SMALL COMPANIES

CONFIDENTIAL

Sample No.☐☐☐☐

QUESTIONNAIRE FOR DIRECTORS & SHAREHOLDERS OF PRIVATE COMPANIES

Please note:

i) In this questionnaire, the term **'small company'** is used to refer to a non-dormant **private** company which satisfies at least two of the following conditions :
- turnover not exceeding £2m;
- balance sheet total not exceeding £0.975m;
- average number of employees not exceeding 50.

Small companies may file **modified/abbreviated** accounts (containing only a balance sheet and some notes) with the Registrar of Companies but they must prepare **full** accounts (containing the full directors' report, auditor's report, profit and loss account, balance sheet and notes to the accounts) for their shareholders.

ii) The information you provide will remain strictly confidential and reported in statistical form so that no identification of individuals or companies will be possible.

iii) Please **answer all questions** by ticking or ranking the appropriate boxes. Please feel free to make marginal comments if you think an answer needs expansion.

SECTION 1: Personal information

1.1 Are you (or were you during the last three years)
- ☐ a director of a small company
- ☐ a shareholder in a small company
- ☐ both of these
- ☐ neither of these

1.2 Your age group:

under 30	30-45	46-60	over 60
☐	☐	☐	☐

1.3 Which is your main area of expertise (please tick one)
- ☐ technical (e.g. engineering, manufacturing)
- ☐ commercial (e.g. buying and selling)
- ☐ financial
- ☐ other professional (e.g. law)
- ☐ other, please specify.......

1.4 Does your work within the company constitute your main business activity:
- ☐ yes
- ☐ no

1.5 What level of accounting experience do you have: (please tick one)
- ☐ accountancy qualification (please state which)......
- ☐ courses in accounting
- ☐ book-keeping experience
- ☐ little or none

SECTION 2: Your company

2.1 How many shareholders are there in your company

1-2	3-4	5-6	7-10	over 10
☐	☐	☐	☐	☐

2.2 Do you have any shareholders who are not directors of your company

☐ yes
☐ no

If yes, do you consider that they take an interest in the accounts and audit of your company

☐ yes
☐ no

2.3 What percentage of your company's share capital is held by the directors and their families (please tick one)

0%	1-25%	26-50%	51-75%	76-99%	100%
☐	☐	☐	☐	☐	☐

2.4 How many directors are there in your company

1	2	3	4	5 and more
☐	☐	☐	☐	☐

2.5 Number of employees in your company is up to

5	10	20	50	100	over 100
☐	☐	☐	☐	☐	☐

2.6 Your company turnover is up to

£0.25m	£0.5m	£1m	£2m	£5m	over £5m
☐	☐	☐	☐	☐	☐

2.7 What is the main <u>advantage</u> of running your business as a company rather than as a partnership or as an individual (please tick one)

☐ tax saving
☐ limitation of liability
☐ ability to raise finance
☐ ease of transfer of ownership
☐ rights and duties of shareholders & directors are defined
☐ other, please specify ....

2.8 What is the main <u>disadvantage</u> of running your business as a company? (please tick one)

☐ tax problems
☐ disclosure of financial information
☐ need for an audit
☐ government form filling
☐ other, please specify ....

SECTION 3: Small company accounts

3.1 Please rank in order of importance the following uses of your company's <u>full</u> annual accounts
(1 =most important, 2 =second most important and so on)

- ☐ reporting to shareholders
- ☐ supporting tax computations
- ☐ providing information to banks (or providers of finance)
- ☐ providing information to management / directors
- ☐ providing information to trade creditors
- ☐ providing information to employees
- ☐ other, please specify ....

3.2 How do you assess the credit worthiness of a new business contact? (please tick all methods used regularly)

- ☐ personal contacts
- ☐ bank references
- ☐ trade references
- ☐ credit reference agencies
- ☐ ask to see their <u>full</u> accounts
- ☐ ask to see their <u>modified</u> accounts
- ☐ other, please specify ....

3.3 How many times in the last year have you had cause to search either directly or through advisers, the publicly filed information about a business contact company?
(please tick one)

0	1	2	3	4	5	more than 5
☐	☐	☐	☐	☐	☐	☐

3.4 Which of the following financial aspects of other companies are you able to assess realistically from their published annual accounts? (please tick one or more)

- ☐ profitability
- ☐ capacity to survive
- ☐ financial trends
- ☐ investment policy
- ☐ none of the above
- ☐ do not read other companies' reports

3.5 Please rank in order of importance for business decisions the following information contained in the published annual accounts of other private companies
(1 =most important, 2 =second most important and so on)

- ☐ turnover (if stated)
- ☐ gross profit
- ☐ profit before tax
- ☐ net current assets
- ☐ total assets
- ☐ audit report
- ☐ cash / fund statement
- ☐ other, please specify ....

3.6 Please rank in order of importance the extent to which the annual accounts influence the following management decisions of your company
(1=most important, 2 =second most important and so on)

☐ pricing
☐ dividends
☐ borrowing
☐ cash management
☐ capital expenditure
☐ staff pay and conditions
☐ directors' remuneration
☐ other, please specify......

3.7 If you personally own shares in one or more publicly quoted companies, do you find their accounts useful in making investment decisions

☐ yes
☐ no
☐ no investment in quoted companies

3.8 Who are your company's main competitors? (please tick one)

☐ small local businesses
☐ large local businesses
☐ large national businesses
☐ other, please specify......

3.9 To your knowledge has any competitor ever used the publicly filed information concerning your company to your company's disadvantage?
☐ yes
☐ no

If yes, please give brief details ....

3.10 If the bank examines your company's annual accounts, what do you consider it is primarily looking for? (please tick one or more)

☐ trends of performance
☐ audit report
☐ auditors' reputation
☐ interest coverage by profit
☐ other, please specify.......
☐ gearing
☐ stability
☐ growth
☐ liquidity

3.11 If the Inland Revenue examine your company's annual accounts, what do you consider they are primarily looking for? (please tick one or more)

☐ trading account items
☐ profit and loss account items
☐ balance sheet items
☐ audit report
☐ auditors' reputation
☐ other, please specify.......

3.12 Do you make copies of your audited accounts available to your employees?
☐ yes
☐ no

3.13 Do you think your employees make any use of the audited accounts: (please tick one box per line)

yes no
☐ ☐ as a tool for wage negotiations?
☐ ☐ to assess the prospective viability of your business?
☐ other, please specify...

3.14 In general, do you feel small companies should disclose in their modified accounts (please tick one)

☐ less information
☐ about the same information as at present
☐ more information

3.15 In general, do you feel small companies should disclose in their full accounts (please tick one)

☐ less information
☐ about the same information as at present
☐ more information

3.16 Do you file full accounts with the Registrar of Companies even when you are entitled to file modified accounts?
☐ yes
☐ no

3.17 In your opinion, which of the following figures should be publicly disclosed in small company accounts? (please tick one or more)

☐ loans from directors
☐ turnover (sales)
☐ profit before tax
☐ value of stock
☐ total directors' emoluments
☐ details of directors' emoluments

3.18 On the whole, are full accounts for the small company (please tick one or more)

☐ useful for shareholders?
☐ a waste of time and money?
☐ intrusive into the owner's private affairs?

3.19 Please rank in order of importance the services provided to your company by its professional accountants (1 =most important, 2 =second most important and so on)

☐ company secretarial services
☐ preparation of accounts
☐ tax advice
☐ audit of accounts
☐ business advice
☐ other, please specify.........

3.20 Who actually prepares your company's annual accounts?

☐ directors
☐ accountants employed by the company other than a director
☐ company's auditors
☐ other, please specify .....

3.21 Are you satisfied with the services you receive from your professional accountants?
☐ yes
☐ no
If no, please state briefly the reasons ....

3.22 Have you recently changed your auditors?
☐ yes
☐ no
If yes, please state briefly the reasons ....

3.23 Were your latest published accounts qualified by your auditors
☐ yes
☐ no

If qualified, was it because of (please tick one)
☐ non-compliance with the Companies Act
☐ non-compliance with the accounting standards
☐ non-going concern
☐ limitation of audit scope due to absence of internal controls
☐ other, please specify.......
☐ do not know

3.24 Which of the following statements do you agree with (please tick one or more)

☐ the cost of producing the <u>full</u> annual accounts outweighs the benefits derived from them

☐ accounts should be produced and filed sooner after the year end

☐ decisions are based on our own management information rather than the <u>full</u> annual accounts

☐ the principal burden of preparing annual accounts is the fee we pay to our professional accountants

☐ the accounting profession should continue to attempt to make accounts more useful to users, even if the cost of preparing the information is higher

3.25 Do you accept that small companies should be required to prepare <u>full</u> accounts for the shareholders containing almost the same information as the accounts of large companies?
☐ yes
☐ no

3.26 Which of the following statements do you agree with (please tick one or more)

The <u>modified</u> accounts of small companies are:
☐ useful to the public
☐ useful for investment decisions
☐ useful for business decisions
☐ a waste of time and money
☐ none of the above

3.27 Do you consider only one set of accounts should be prepared both for the shareholders of small companies and for filing?

- ☐ yes
- ☐ no

3.28 Do you consider if only one set of accounts is prepared both for the shareholders and for filing then it will: (please tick one box per line)

yes	no	
☐	☐	improve the use of publicly filed information?
☐	☐	reduce the burden of accounting requirements on small companies?
☐	☐	reduce the associated audit effort?
		☐ other, please specify .....

3.29 If only one set of accounts is prepared both for the shareholders and for filing, which of the following items should be included:

	Full	**Abbreviated/Shortened**
- directors' report	☐	☐
- balance sheet	☐	☐
- profit and loss account	☐	☐
- cash / fund statement	☐	☐
- notes to the accounts	☐	☐

-☐ other, please specify.......

SECTION 4: Small company audit

4.1 If the requirement to have an annual audit of your company's accounts was removed would you: (please tick one)

- ☐ continue to have an audit mainly for the shareholders
- ☐ continue to have an audit for external users of the accounts (e.g. the bank)
- ☐ continue to have an audit for the efficient running of the company
- ☐ choose not to have an audit but retain a firm of accountants for other purposes
- ☐ choose not to employ professional accountants

4.2 What is the main benefit small companies obtain from the annual audit? (please tick one)

- ☐ easier acceptance of tax computations
- ☐ assurance of efficient financial management
- ☐ to satisfy the bank's lending requirements
- ☐ no significant advantage
- ☐ other, please specify ......

4.3 What is the most important function of the audit (please tick one)

- ☐ report to directors
- ☐ report to creditors
- ☐ to detect frauds
- ☐ report to shareholders
- ☐ other, please specify........

4.4 Which one of the following statements do you agree with most strongly? (please tick one)

☐ there should be no change in the current auditing requirements and standards for small companies

☐ small companies should continue to be audited but separate auditing standards should be developed

☐ small companies should be allowed to opt for a statutory review instead of an audit

☐ the audit requirement for small companies should be abolished subject to protection of minority shareholders

☐ the audit requirement for small companies, all of whose members are directors, should be abolished subject to annual confirmation in general meeting by all members

☐ the audit requirement for small companies should be abolished

4.5 Do you think the substitution of a statutory review in place of an audit will: (please tick one box per line)

yes	no	
☐	☐	create confusion over the nature and the scope of a review
☐	☐	reduce the overall costs
☐	☐	provide almost the same assurances as audit
		☐ other, please specify............

SECTION 5: Others

5.1 If you have any comments in respect of the issues raised in this questionnaire, in particular or relating to small company financial reporting in general, please state below:

....
....
....

5.2 Are you interested in discussing further the issues raised in this questionnaire

☐ yes
☐ no

5.3 Do you wish to receive a complimentary summary of the findings of this survey

☐ yes
☐ no

If you have answered 'yes' to 5.2 and/or 5.3, please complete below:

Name ....
Address ....
....
Business Tel. No. ....

THANK YOU FOR YOUR HELP IN COMPLETING THIS QUESTIONNAIRE

Please RETURN the completed questionnaire in the enclosed stamped addressed envelope to:

Mr. John H. Bowen FCA FCT,
Secretary - London Practitioner Board,
London Society of Chartered Accountants,
Friendly House, 52 Tabernacle Street, London EC2A 4NB.

APPENDIX 3

QUESTIONNAIRE FOR AUDITORS OF THE ACTIVE, INDEPENDENT PRIVATE SMALL COMPANIES

CONFIDENTIAL

Sample No. ☐☐☐☐

QUESTIONNAIRE FOR AUDITORS OF PRIVATE COMPANIES

Please note:

i) In this questionnaire, the term **'small company'** is used to refer to a non-dormant **private** company which satisfies at least two of the following conditions :

- -turnover not exceeding £2m;
- -balance sheet total not exceeding £0.975m;
- -average number of employees not exceeding 50.

Small companies may file **modified/abbreviated** accounts (containing only a balance sheet and some notes) with the Registrar of Companies but they must prepare **full** accounts (containing the full directors' report, auditor's report, profit and loss account, balance sheet and notes to the accounts) for their shareholders.

ii) The information you provide will remain strictly confidential and reported in statistical form so that no identification of individuals or firms will be possible.

iii) Please **answer all questions** by ticking or ranking the appropriate boxes. Please feel free to make marginal comments if you think an answer needs expansion.

SECTION 1: Personal information

1.1 Are you (or were you during the last three years) the auditor of one or more private companies?
☐ yes ☐ no

1.2 Your age group: under 30 ☐ 30-45 ☐ 46-60 ☐ over 60 ☐

1.3 What is your position in the firm?
partner ☐ manager ☐ other, please specify....... ☐

1.4 How many years have you been a member of a professional accountancy body?
under 5 ☐ 5-10 ☐ 11-20 ☐ 21-30 ☐ over 30 ☐

1.5 How many years have you worked for your present firm?
under 5 ☐ 5-10 ☐ 11-20 ☐ 21-30 ☐ over 30 ☐

SECTION 2: Your firm

2.1 How would you describe your practice? (please tick one)
local/regional ☐ national ☐ international ☐

2.2 How many partners are there in your firm?
1 ☐ 2-5 ☐ 6-10 ☐ 11-20 ☐ 21-50 ☐ over 50 ☐

2.3 How many professional staff (excluding partners) are there in your firm?
0-10 ☐ 11-25 ☐ 26-50 ☐ 51-100 ☐ 101-200 ☐ over 200 ☐

SECTION 3: Your small company clients

3.1 Please estimate on average what percentage of your small company clients have directors (including their families) with the following levels of shareholdings:

% of shareholdings held by directors & their families	% of small companies up to:
- 0%	...%
- 1-25%	...%
- 26-50%	...%
- 51-75%	...%
- 76-99%	...%
- 100%	...%
	100%

3.2 What do you consider to be the main advantage to a typical proprietor of a small company of running their business as a company rather than as a partnership or as an individual? (please tick one)

- ☐ tax saving
- ☐ limitation of liability
- ☐ ability to raise finance
- ☐ ease of transfer of ownership
- ☐ rights and duties of shareholders & directors are defined
- ☐ other, please specify.........

3.3 What do you consider to be the main disadvantage to a typical client of running their business as a company? (please tick one)

- ☐ tax problems
- ☐ disclosure of financial information
- ☐ need for an audit
- ☐ government form filling
- ☐ other, please specify.......

SECTION 4: Small company accounts

4.1 Please rank in order of importance the following users of small company's full annual accounts? (1=most important, 2=second most important and so on)

- ☐ banks and loan creditors
- ☐ management/directors
- ☐ employees
- ☐ other, please specify.........
- ☐ shareholders
- ☐ tax authorities
- ☐ business contacts

4.2 Please rank in order of importance to users for business decisions, the following information contained in the published accounts of other private companies? (1=most important, 2= second most important and so on)

- ☐ turnover (if stated)
- ☐ profit before tax
- ☐ cash / fund statement
- ☐ other, please specify......
- ☐ net current assets
- ☐ total assets
- ☐ audit report
- ☐ gross profit

4.3 If the bank examines your small company client's annual accounts, what do you consider it is primarily looking for? (please tick one or more)

- ☐ trends of performance
- ☐ interest coverage by profit
- ☐ auditor's reputation
- ☐ gearing
- ☐ other, please specify.......
- ☐ stability
- ☐ growth
- ☐ liquidity
- ☐ audit report

4.4 Do you consider the Inland Revenue place greater reliance on the audited accounts of small companies than on the unaudited statements received from sole traders and partnerships?

☐ yes ☐ no

4.5 If the Inland Revenue examine your small company client's annual accounts, what do you consider they are primarily looking for? (please tick one or more)

- ☐ trading account items
- ☐ profit and loss account items
- ☐ balance sheet items
- ☐ audit report
- ☐ auditor's reputation
- ☐ other, please specify.......

4.6 Do you consider in a small company, the employees make any use of the audited accounts: (please tick one box per line)

yes	no	
☐	☐	as a tool for wage negotiations?
☐	☐	to assess the prospective viability of their employer's company?

☐ other, please specify.......

4.7 Please estimate on average what percentage of your small company clients file the <u>modified</u> accounts rather than <u>full</u> accounts?

up to :	20%	40%	60%	80%	100%
	☐	☐	☐	☐	☐

4.8 Please estimate on average how many months after the end of their accounting reference period, your small company clients have filed their accounts with the Companies Registrar during the last year?

up to :	10	11	12	13	14	15 months & more
	☐	☐	☐	☐	☐	☐

4.9 Please estimate on average what percentage of your small company clients have filed any 'additional statements' (e.g. an employee report) with their accounts with the Companies Registrar during the last year?

up to :	0%	10%	20%	30% & more
	☐	☐	☐	☐

4.10 How should the burden of producing annual accounts for small companies be reduced? (please tick one or more)

- ☐ reduce scope of audits
- ☐ better client bookkeeping
- ☐ not possible
- ☐ other, please specify.......
- ☐ reduce disclosure
- ☐ eliminate audit
- ☐ computerisation

4.11 Which of the following statements do you agree with (please tick one or more)

- ☐ the cost of producing the <u>full</u> annual account outweighs the benefits derived from them
- ☐ the regulation of auditors under the Companies Act 1989 has resulted in extra costs to auditors which are passed to their audit clients
- ☐ the current Companies Act requirements for small companies are unnecessarily complex and burdensome
- ☐ the application of the 'true and fair' concept to the accounts of companies under the reduced disclosure regime is not possible
- ☐ the accounting profession should continue to attempt to make accounts more useful to users, even if the cost of preparing the information is higher
- ☐ there is a need for introduction of separate accounting and auditing standards for small companies
- ☐ some small companies would prefer to <u>disincorporate</u> in order to reduce their accounting and audit burden if favourable legal and tax reforms were in force

4.12 Which of the following accounting standards do you consider should apply to small companies? (please tick one or more)

- ☐ SSAP 6: Extraordinary Items and Prior Adjustments
- ☐ SSAP 9: Stocks and Work in Progress
- ☐ FRS1: Cash Flow Statement
- ☐ SSAP 12: Accounting for Depreciation
- ☐ SSAP 15: Accounting for Deferred Taxation
- ☐ SSAP 21: Accounting for leases and hire purchase contracts
- ☐ none of these

4.13 Do you accept that small companies should be required to prepare <u>full</u> accounts for the shareholders containing almost the same information as the accounts of large companies?

☐ yes ☐ no

4.14 In general, do you feel small companies should disclose in their <u>full</u> accounts (please tick one)

- ☐ less information
- ☐ more information
- ☐ about the same information as at present

4.15 In general, do you feel small companies should disclose in their <u>modified</u> accounts (please tick one)

- ☐ less information
- ☐ more information
- ☐ about the same information as at present

4.16 Which of the following figures should be publicly disclosed in small company accounts?
(please tick one or more)

- ☐ loans from directors
- ☐ total directors' emoluments
- ☐ details of directors' emoluments
- ☐ turnover (sales)
- ☐ profit before tax
- ☐ value of stock

4.17 On the whole, are <u>full</u> accounts for the small company (please tick one or more):

- ☐ useful for shareholders?
- ☐ a waste of time and money?
- ☐ intrusive into the owner's private affairs?

4.18 Which of the following statements do you agree with (please tick one or more)

The <u>modified</u> accounts of small companies are:
- ☐ useful to the public
- ☐ useful for investment decisions
- ☐ useful for business decisions
- ☐ a waste of time and money
- ☐ none of the above

4.19 Do you consider <u>only one set of accounts</u> should be prepared both for the shareholders of small companies and for filing?

☐ yes ☐ no

4.20 Do you consider if <u>only one set of accounts</u> is prepared both for the shareholders and for filing then it will: (please tick one box per line)

yes	no	
☐	☐	improve the use of publicly filed information?
☐	☐	reduce the burden of accounting requirements on small companies?
☐	☐	reduce the associated audit effort?
		☐ other, please specify..........

4.21 If <u>only one set of accounts</u> is prepared both for the shareholders and for filing, which of the following items <u>should be included:</u>

	Full	**Abbreviated/Shortened**
- directors' report	☐	☐
- balance sheet	☐	☐
- profit and loss account	☐	☐
- cash / fund statement	☐	☐
- notes to the accounts	☐	☐

- ☐ other, please specify....

4.22 Do you think the right to prepare and publish <u>only one set of accounts</u> should apply to: (please tick one)

- ☐ small owner-managed companies only
- ☐ all small companies
- ☐ a sub-category of small companies
- ☐ none of these
- ☐ other, please specify ....

4.23 Do you think the current thresholds used for the definition of a small company should be (please tick one)

☐ further widened ☐ further narrowed ☐ left as it is

SECTION 5: Small company audit

5.1 What is the main benefit small companies obtain from the annual audit? (please tick one)

☐ easier acceptance of tax computations
☐ assurance of efficient financial management
☐ to satisfy the bank's lending requirements
☐ no significant benefit
☐ other, please specify......

5.2 Please rank in order of importance the following difficulties in auditing small companies?
(1 =most important, 2 =second most important and so on)

☐ understatement of sales
☐ stock valuation
☐ confirmation of going-concern basis
☐ lack of internal control
☐ discovery of all creditors and other liabilities
☐ other, please specify ....

5.3 Do you consider the withdrawal of the old 'example 6' audit report (containing a qualification due to limitation of scope and acceptance of assurances from management in the absence of internal controls) has: (please tick one box per line)

yes	no	
☐	☐	helped the auditors in their reporting
☐	☐	improved the understandability of the audit report
☐	☐	resulted in more support for the argument to maintain the audit for small companies

5.4 Do you consider the substitution of a statutory review in place of an audit will: (please tick one box per line)

yes	no	
☐	☐	create confusion over the nature and the scope of a review
☐	☐	reduce the overall costs
☐	☐	provide almost the same assurances as audit

☐ other, please specify...............

5.5 If the audit requirement for small companies were abolished do you estimate that the income of your practice would (please tick one)

☐ increase significantly
☐ increase a little
☐ stay much the same
☐ decrease a little
☐ decrease significantly

5.6 Should the <u>audit requirement</u> for private companies with turnover below the VAT threshold (currently £36,600) ('<u>very small</u>' companies) be abolished?

☐ yes ☐ no

5.7 Should the <u>audit requirement</u> for private owner-managed companies with turnover in excess of the VAT threshold but less than 25% of the small companies turnover limit (currently £500,000) ('proprietary' companies), subject to unanimous decision of shareholders, be: (please tick one)

- ☐ substituted with a <u>review</u> carried out by an independent, qualified accountant?
- ☐ substituted with a <u>compilation report</u> provided by a non-independent, qualified accountant?
- ☐ abolished without any substitution?
- ☐ retained?

5.8 Should <u>the audit requirement</u> for all other private companies with turnover in excess of the VAT threshold but less than the turnover limit (currently £2m) be: (please tick one)

- ☐ substituted with a <u>review</u>?
- ☐ substituted with a <u>compilation report</u>?
- ☐ abolished without any substitution?
- ☐ retained without any change?
- ☐ retained subject to development of separate auditing standards?

5.9 If the audit requirement for small companies were abolished would the quality of your overall service to small company clients

- ☐ improve (e.g. because you could concentrate on matters more important to them)
- ☐ deteriorate (e.g. because small companies would not be willing to pay for beneficial services which are incidental to an audit)
- ☐ stay much the same

5.10 If audits were not compulsory, please estimate on average what percentage of (please tick one box per line)

up to:	10%	25%	50%	75%	over 75%
- your small company clients would choose not to have an audit	☐	☐	☐	☐	☐
- your small company clients would cease to employ an accountant	☐	☐	☐	☐	☐
- reduction in fees you could make if a review was performed instead of an audit	☐	☐	☐	☐	☐
- reduction in fees you could make if no review was performed	☐	☐	☐	☐	☐

SECTION 6: Your services to small company clients

6.1 Please rank the services you provide to your small company clients in order of importance to them :
(1 =most important, 2=second most important and so on)

☐ company secretarial services ☐ tax advice
☐ preparation of accounts ☐ audit of accounts
☐ other, please specify....... ☐ business advice

6.2 Please estimate on average what percentage of:
(please tick one box per line)

up to:	20%	40%	60%	80%	100%
- your working week is spent providing services to your small company clients?	☐	☐	☐	☐	☐
- your total number of clients are small companies?	☐	☐	☐	☐	☐
- your small company clients use the following services:					
preparation of accounts	☐	☐	☐	☐	☐
audit of accounts	☐	☐	☐	☐	☐
tax advice	☐	☐	☐	☐	☐
business advice	☐	☐	☐	☐	☐
company secretarial services	☐	☐	☐	☐	☐
- your small company clients are managed by individuals for whom personal services (e.g.income tax return) also provided	☐	☐	☐	☐	☐
- your overall fees is from your small company clients for:					
all services (including audit)	☐	☐	☐	☐	☐
audit services only	☐	☐	☐	☐	☐

SECTION 7: Others

7.1 If you have any comments in respect of the issues raised in this questionnaire, in particular or relating to small company financial reporting in general, please state below:
....
....

7.2 Are you interested in discussing further the issues raised in this questionnaire
☐ yes ☐ no

7.3 Do you wish to receive a complimentary summary of the findings of this survey
☐ yes ☐ no
If you have answered 'yes' to 7.2 and/or 7.3, please complete below:
Name ....
Address ....
Business Tel. No. ....

THANK YOU FOR YOUR HELP IN COMPLETING THIS QUESTIONNAIRE

Please RETURN the completed questionnaire in the enclosed stamped addressed envelope to:

Mr. John H. Bowen FCA FCT,
Secretary - London Practitioner Board,
London Society of Chartered Accountants,
Friendly House, 52 Tabernacle Street, London EC2A 4NB.

APPENDIX 4

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