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The influence of accounting regulation simplification on the financial reporting of micro entities – the case of Croatia

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The specifics of the business of micro entities highlight, in particular, the complexity of the problem of accounting regulations for this segment of the economy. The paper starts from the basic research question of whether the simplification of accounting regulations is necessary or not, particularly for those micro entities where ownership and management functions are integrated into the same person. In order to achieve the research objectives, the effects of accounting regulations simplification on decision-making processes in micro entities were tested. Empirical research has confirmed that the simplification of accounting regulation is justified, because it would have effects on the cost reduction, while the information quality base will not be diminished.

Keywords: financial reporting; accounting standards; accounting directives; accounting regulation simplification; micro enterprises; Croatia

JEL classification: L29, L53, M40, M41

1. Introduction

For many years the financial reporting of SMEs has intrigued the accounting practices as well as the wider business and scientific community. The complexity of financial reporting regulation and disproportionate administrative burden depending on the company size have become the discussion topic of all important meetings between representatives of accounting information users (management, investors and accountants). In this sense, problems of micro entities in particular are highlighted. Regarding the existing classification criteria together with large entities, SMEs particularly stand out. However, there is a significant group of small businesses – micro entities – which should be given special attention due to their specific business environment. The existing financial reporting system is not suitable for micro entities, which is confirmed by the fact that the European Commission recognises the problems that micro entities are faced with, so it proposed the modernisation and simplification of accounting directives. Since micro businesses primarily operate locally and the managing of the company is usually in the domain of its owner, there is usually no need for external protection of users. Although preparation of financial statements represents a certain kind of protection for owners/mangers they consider the public disclosure of general purpose financial statements to be a great burden for them, primarily in the context of the costs and benefits of preparing financial

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statements. Considering this, specific accounting solutions should have been developed whose purpose is to enable the convergence of financial and tax accounting for this segment of the economy. In light of the above-mentioned problems, the main results of the conducted empirical research about the possibilities of financial reporting simplifications for micro entities with particular emphasis on their impact on financial reporting of Croatian micro entities are emphasised in this paper.

2. Theoretical background

Generally, micro enterprises are defined as the smallest companies in the category of small and medium-sized entities (SMEs). Previous results of studies have shown that this category is not recognised within national legislations of many countries. Hence, those countries that recognise 'micro entity' as a separate category usually differentiate this category according to the number of employees (fewer than 10 employees). The definition of SMEs can be found in the recommendations of the European Commission, which is reported in Table 1.

It is interesting that the category of micro entities was introduced relatively late, in 2005. Until then there was only classification on small- and medium-sized entities. However, it should be noted that these are just the recommendations and, as such, are not binding instruments for Member States, but EU Member States could use the lower criteria or just one criterion, such as the number of employees. It is particularly interesting to see which EU Member States recognise this category of companies in their national legislation (Table 2). In accordance with the research results, Germany, the Czech Republic, Slovenia, Hungary and Poland have adopted the recommendations of the EU from 2005, while, on the other hand, Denmark and Estonia have adopted a much lower criteria. Then again, Belgium, Finland, Ireland, Italy, Norway and Great Britain do not recognise this group of entities (Dečman, 2012).

Classification criteria are especially important in the area of accounting because there is a strong need for the simplification of accounting regulations and therefore the

Table 1. Criteria for the classification of micro, small and medium entities as recommended by the EU and the EU accounting directives.

	Number of employees	Revenues (€)	Total asset (€)
2013. medium	250	40,000,000	20,000,000
small	50	8,000,000	4,000,000
micro	10	700,000	350,000
2011. medium	250	40,000,000	20,000,000
small	50	10,000,000	5,000,000
micro	10	700,000	350,000
2005. medium	250	50,000,000	43,000,000
small	50	10,000,000	10,000,000
micro	10	2,000,000	2,000,000
1996. medium	250	40,000,000	27,000,000
small	10	7,000,000	5,000,000

Source: Small and Medium Practices Committee; (2006) Micro-Entity Financial Reporting: Perspectives of Preparers and Users. New York: IFAC; Proposal of a Directive repealing and replacing the Accounting Directives 78/660/EEC and 83/349/EEC Directive (2011); Directive 2013/34/EU of the European Parliament and of the Council of 26 June 2013 on the annual financial statements, consolidated statements and related reports of certain types of undertakings, amending Directive 2006/43/EC of the European Parliament and of the Council and repealing Council Directives 78/660/EEC and 83/349/EEC (2013).

Table 2. EU member states that have introduced micro-entities in the national legislation.

EU member state	Classification criteria for micro entitiesnumber of employees/ the amount of revenue/total assets
Czech Republic, Germany, Hungary, Poland, Slovenia	10 / \$2.6 m / \$2.6 m
Denmark	10 / \$1.7 m / \$0.7 m
Estonia	10 / \$0.8 m / \$0.4 m
Romania	10 / - / -

Source: IFAC. (2006). Micro-entity financial reporting: Perspectives of preparers and users, Small and Medium Practices Committee, IFAC, New York cited from: Dečman, N. (2012). Financial reporting specificities of micro entities, Proceedings of 3rd International Conference "Vallis Aurea" Focus on: Regional Development, Polytechnic of Pozega, Croatia and DAAAM International Vienna, Austria, 0199–0205.

recommendations of the EU and consequently Directives are increasingly restrictive. Micro entities are defined as those that do not exceed two of the following three criteria: an average number of 10 employees, the value of total assets €350,000 and the amount of revenue €700,000 (European Parliament & Council of the European Union, 2013). As well as quantitative classification criteria, there are also qualitative criteria. For example, according to IASB, the users of International Financial Reporting Standards for Small and Medium-sized Entities are those who do not have public accountability and publish general purpose financial statements for external users (Dečman, 2012).

Micro-entities, as a special category of small businesses have limited resources with respect to satisfying the demanding criteria of existing regulations. However, at the same time they should apply the same rules of financial reporting as large entities (exceptionally, in certain countries (German Commercial Code § 241a), some very small businesses can be completely exempt from full accounting), which creates an additional administrative burden disproportionate to their size. Therefore, it is important to point out the possibilities of exemption of micro entities from existing regulatory requirements in order to reduce excessive administrative burden. Respecting the specific needs of users of micro entities' financial statements and the fact that previous studies suggest that the costs exceed the benefits of public disclosure of financial statements, regulators introduce significant changes in financial reporting system of micro entities. First of all, International Financial Reporting Standards for SMEs (IFRS for SMEs) were issued in 2009, and the activities for possible simplification of accounting regulations in the EU were undertaken. Furthermore, the consultative research on the need for modification or modernisation and simplification of the existing EU Accounting Directives was conducted. Among other things, the main question was whether IFRS for SMEs are suitable for use in micro entities or not. The research results indicate that the majority of respondents believe that the result of the application of these Standards for micro entities would be contradictory, i.e. the administrative burden would be increased instead of reduced, and the costs of preparing and auditing of financial statements would also increase (Neag, 2010 and European Commission, 2010 cited from Dečman, 2012). Such an opinion was understandably not adopted by members of IASB. They accept the fact that a typical micro entity will have no need to use all the standards and found the solution in the publication of the Roadmap that will bring Standards closer to the smallest companies, including only those topics that are likely to occur in practice for micro entities. Since the Guide for the Micro-sized Entities Applying the IFRS for SMEs (2009) is not a separate standard but simplifies existing standards, the Guide does not change the principles of recognition and measurement of financial statement elements.

The guide was released in June 2013 and it was designed for a micro entity that has the following typical characteristics (IFRS Foundation, 2013): (a) few employees and often owner-managed, (b) low or moderate levels of revenue and gross assets, and (c) does not have investments in subsidiaries, associates or joint ventures; hold or issue complex financial instruments; issue shares or share options to employees or other parties in exchange for goods or services. The guide contains 99 pages including numerous illustrative examples.

The content of the Guide is identical to the content of IFRS for SMEs (Table 3). However, guidance does not cover all the requirements of IFRS for SMEs. It contains cross-references to IFRS for SMEs for matters not covered by the guidance.

For more than 30 years Accounting Directives represent a framework for preparing general purpose financial statements in the European Union Member States. The fact is that Directives have not been substantially changed since they were issued for the first time. Lately, the frequently asked question is if the existing Accounting Directives meet the information needs of financial statement users in smaller companies, and whether and to what extent they should be changed. The European Commission has recognised the SMEs' problems of financial reporting and accepted the proposal that such companies should adopt simpler rules for financial reporting. In 2007, the European Council concluded that the reduction of administrative burdens is important for the expansion of the EU economies. Accounting was recognised as one of the key areas where it is possible to reduce the administrative costs (European Parliament & Council of the European Union, 2012). In October 2011, the European Commission, as part of the Responsible Business package with its 'Think Small First' principle, proposed the replacement of IV and VII EU Directive with a completely new directive called 'Directive 2013/34/EU of the European Parliament and of the Council of 26 June 2013 on the annual financial statements, consolidated statements and related reports of certain types of undertakings'. This proposal was finally, with certain modifications adopted in June 2013. EU Member States are obliged to implement the provisions of the Directive into national law by 20 July 2015 and apply its provisions from the 1 January 2016. Generally, these amendments by the European Commission emphasise the harmonisation of financial reporting practices at EU level, especially on the part of minimising the administrative burdens of legislation for smaller entities. The proposed amendments require each Member State distinguish small businesses from large ones and, in connection to this, enable a regulatory burden in proportion to the size of the company. Some of the proposed simplifications for small businesses are: drawing up abridged balance sheets and profit and loss accounts, the exemption from preparing consolidated financial statements for small groups, the exemption from the obligation of drawing up management reports, the exemption from publication of the profit and loss accounts and the management report as well as the exemption from the obligation to audit financial statements, and so on.

Special attention is paid to the possibilities of simplifying financial reporting of micro entities (taking into account the amendment (2012/6/EU) of IV EU Directive from March 2012) (European Parliament & Council of the European Union, 2012). The European Commission offers the following simplification of financial reporting for micro entities (Dečman, 2012):

(1) preparing 'abridged' financial statements (Table 4),
(2) exemption from the public disclosure of all financial statements with obligation to present basic information in the balance sheet and that information should be

Table 3. Contents of the guide for micro-sized entities applying the IFRS for SMES (2009).

IFRS for SMEs	Contents	Guide section	Contents
IFRS for SME 1	Small and Medium-sized Entities	Guide Section 1	Intended scope of this Guide
IFRS for SME 2	Concepts and Pervasive Principles	Guide Section 2	Concepts and Pervasive Principles
IFRS for SME 3	Financial Statement Presentation	Guide Section 3–8	Financial Statement Presentation
IFRS for SME 4	Statement of Financial Position		
IFRS for SME 5	Statement of Comprehensive Income and Income Statement		
IFRS for SME 6	Statement of Changes in Equity and Statement of Income and Retained Earnings		
IFRS for SME 7	Statement of Cash Flows		
IFRS for SME 8	Notes to the Financial Statements		
IFRS for SME 9	Consolidated and Separate Financial Statements	Guide Section 9	Consolidated and Separate Financial Statements
IFRS for SME 10	Accounting Policies, Estimates and Errors	Guide Section 10	Accounting Policies, Estimates and Errors
IFRS for SME 11	Basic Financial Instruments	Guide Section 11 and 12	Financial Instruments
IFRS for SME 12	Other Financial Instruments Issues		
IFRS for SME 13	Inventories	Guide Section 13	Inventories
IFRS for SME 14	Investment in Associates	Guide Section 14 and 15	Investment in Associates and Joint Ventures
IFRS for SME 15	Investment in Joint Ventures		
IFRS for SME 16	Investment Property	Guide Section 16	Investment Property
IFRS for SME 17	Property, Plant and Equipment	Guide Section 17	Property, Plant and Equipment
IFRS for SME 18	Intangible Asset other than Goodwill	Guide Section 18	Intangible Asset other than Goodwill
IFRS for SME 19	Business Combinations and goodwill	Guide Section 19	Business Combinations and goodwill
IFRS for SME 20	Leases	Guide Section 20	Leases
IFRS for SME 21	Provisions and Contingencies	Guide Section 21	Provisions and Contingencies
IFRS for SME 22	Liability and Equity	Guide Section 21	Liability and Equity
IFRS for SME 23	Revenue	Guide Section 23	Revenue
IFRS for SME 24	Government Grants	Guide Section 24	Government Grants

(*Continued*)

Table 3. (*Continued*).

IFRS for SMEs	Contents	Guide section	Contents
IFRS for SME 25	Borrowing Costs	Guide Section 25	Borrowing Costs
IFRS for SME 26	Share-based payment	Guide Section 26	Share-based payment
IFRS for SME 27	Impairment of Assets	Guide Section 27	Impairment of Assets
IFRS for SME 28	Employee Benefits	Guide Section 28	Employee Benefits
IFRS for SME 29	Income Tax	Guide Section 29	Income Tax
IFRS for SME 30	Foreign Currency Translation	Guide Section 30	Foreign Currency Translation
IFRS for SME 31	Hyperinflation	Guide Section 31	Hyperinflation
IFRS for SME 32	Events after the End of the Reporting Period	Guide Section 32	Events after the End of the Reporting Period
IFRS for SME 33	Related Party Disclosures	Guide Section 33	Related Party Disclosures
IFRS for SME 34	Specialised Activities	Guide Section 34	Specialised Activities
IFRS for SME 35	Transition to the IFRS for SMEs	Guide Section 35	Transition to the IFRS for SMEs

Source: According to IFRS for SMEs and a Guide for Micro-sized Entities Applying the IFRS for SMEs (2009).

in accordance with national legislation. This information should be delivered to at least one competent commercial register and such information should be available on request;

(3) exemption of micro-entities from the requirement of calculating and presenting of accruals and deferrals; information about those amounts may be disclosed in the notes to the financial statements or as the foot of the balance sheet;
(4) exemption from the obligation to prepare an annual report;
(5) Member States, in most cases, will not be able to require the use of fair value in preparing the financial statements, due to limited notes, because they will not know whether the value of the assets in the balance sheet include the fair value or not.

Despite recent amendments to the Directive, which significantly reduced financial reporting requirements, especially for the smallest businesses, it remains to be seen the extent to which Member States will adopt the proposed simplification and what kind of influence the implementation of those changes in national legislation will have on cost savings. Related to the above, the Commission is obligated to submit its report to Parliament on the savings and real reduction in the administrative burden of micro entities in the EU by the end of July 2018.

3. Review of previous research

The business decision-making process in small companies is specific for several reasons. The main reason is the fact that the functions of management and ownership are often

Table 4. Abridged balance sheet and profit and loss account for micro entities.

Balance sheetfor micro entities	P&L accountfor micro entities
A. Subscribed capital unpaid	A. Net turnover
B. Formation expenses	B. Other income
C. Fixed assets	C. Cost of raw materials and consumables
D. Current assets	D. Staff cost
Total assets	E. Value adjustments
A. Capital and reserves	F. Other charges
B. Provisions	G. Tax
C. Non-current liabilities	H. Profit or loss
D. Current liabilities	
Total sources of assets	

Source: Directive 2013/34/EU of the European Parliament and of the Council of 26 June 2013 on the annual financial statements, consolidated statements and related reports of certain types of undertakings.

united in one person, the manager-owner. As a result, the manner of reporting and use of information in small entities will significantly differ from large enterprises. Usually, accounting information represents the most important base for making significant business decisions, but is not the sole factor influencing the final decision. This pose the question; what information do micro entities use for the purposes of business decision-making?

This paper presents the existing experience on usage of accounting information by the smallest companies. Thee potential effects, as well as the restrictions on the use of simplified rules of preparation and presentation of financial statements in micro entities are also discussed.

Collis and Jarvis (2000, 2002) and Collis (2008) conducted research on the intensity and frequency of use of information presented in the financial statements by the owners-managers. The main purpose of this research was to learn how important presented information in the financial statements is in relation to other sources of information that can be used for company management. They also discussed the reasons for publishing the complete set of financial statements of small businesses when companies already have the option of disclosing abridged reports. The research results indicate three most important sources of information for management: periodic managerial reports, information and statements about cash flows and reports for the banks. Previous studies showed that managers of small businesses consider financial statements as an important tool for business management. However, new findings imply the fact that managers still underuse that information. The fact that mandatory financial statements should be prepared to meet the information requirements of a wide range of financial statements users, which are mostly investors' requirements (which are not the primary users of financial statements in small businesses), validates this statement. Overall research findings confirm the differences in defining the objectives of financial reporting and information requirements of users, depending on the company size. Furthermore, the main benefit of financial reporting of smaller companies is the validation and verification of the achieved business results.

Similarly, in Ireland in 1995, Barker and Noonan (cited from IFAC, 2006), among others, explored the purpose of financial statements preparation. The research results show that the respondents (owners-managers) consider reports useful primarily for the purposes of planning and decision-making (35%). Then follow the satisfaction of tax (21%) and banking (19%) requests and the needs and evaluation of actual results of business operations (11%). It should be noted that research has shown that, for the purpose of decision-making, the owners/managers, more often use the periodic (weekly/monthly) reports than annual financial reports. This is understandable because they usually manage daily operations and therefore they are more familiar with internal reports, which they consider helpful. But the question remains, how do SMEs actually use the information of internal reporting and to what extent?

Sian and Roberts (2009) further investigate the potential demand, as well as the usefulness of existing accounting guidance for the presentation of financial information to interested users designed specifically for SMEs. Similar to other studies, the major users of financial statements of SMEs are considered to be the owners who run the company. Moreover, 55% of the respondents send statements to tax authorities. Considering that the questionnaire was sent to the owners and their accountants, the authors have got interesting results regarding the usefulness of financial statements. From the accountants' perspective, the usefulness of financial statements is evident in the validating of business results rather than in business decision-making and planning. On the other hand, similar results can be found in the answers of owners/managers who use financial statements mostly for the purpose of analysing the company's performance through time, but also as a tool for improving profitability. This research also confirms the fact that most SMEs use financial statements for management purposes, but not often enough.

Son, Marriott, and Marriott (2006) conducted a qualitative study, using the example of the transition country's – Vietnamese – SMEs, regarding the perception and information requirements of financial statements users. According to the research results, major users of financial statements are tax authorities and state agencies. Banks are represented too, but to a much lesser extent. All users agree that financial statements are major tools in communication between SMEs and external stakeholders but they want information about future business aspects as well. This is primarily related to various budgets and cash flow information. Full consensus among respondents was achieved regarding the reasons for financial statements preparation, which are fulfilling the legal obligation of financial statements disclosure, calculation of tax obligation, delivery of reports to state agencies for statistical purposes, and so on.

The main purpose of the study conducted in Australia (Halabi, Barrett, & Dyt, 2010) was to understand whether financial information used to calculate the tax liability, might also be used for the purpose of business decisions. They highlighted the issue of whether the owners/managers of the smallest, micro businesses use financial information to assess the effectiveness of operations and the accountants' role in that process. The owners have declared a low level of financial statements usefulness. Results generally indicate that they do not consider these reports 'real' because they are prepared for tax purposes, which implies that calculated profit is deliberately low in order to reduce tax liability. Accountants are mainly engaged in order to complete tax returns. Beside mandatory financial statements, only a minority of respondents obtain from their accountants, the insight in other important information. They point out that such additional information helps them in the evaluation of business results. The explanation of weak usage of financial statements for the purpose of business management could be found in the misunderstanding of accounting information and the fact that the statements are usually prepared for tax purposes. Researchers reasonably raise the question of whether accountants should prepare and adjust the financial statements in a form that will be understandable to the owners. Alternatively, the question is, should the owners have better accounting knowledge.

The presented research indicates a trend of weak use of accounting information by the smallest companies owners/managers. The usefulness of accounting information increases proportionally with the company size. Regulation essentially defines the content and structure of publicly presented accounting information. Therefore, the aim of empirical research was to investigate whether its simplification significantly affects the quality of the information base for decision-making in micro enterprises.

4. Methodology and results

In order to identify the needs, possibilities, and also the effects that simplification of financial reporting regulation would bring to SMEs, empirical research on current issues in financial reporting of SMEs was conducted. Results presented in this paper are part of the empirical research conducted for the purposes of a doctoral dissertation (Dečman, 2013). The data were collected in the period between August 2012 and January 2013.[1] The study, among other things, explored the different challenges that SMEs, especially the smallest group of entities that employ up to 10 workers, face in business practices. In regards to this, it was important to determine whether accounting rules should be significantly simplified for SMEs and, if so, to what extent certain simplifications affect the total entities' costs. A few possible simplifications of accounting regulations were observed whereby respondents on the Likert scale 1–3 (1 = no impact on cost reduction, 2 = insignificant cost reduction, 3 = significant cost reduction) evaluated the extent to which the above simplifications affect the entities' cost. At the same time, it was important to analyse if the simplification of regulations will significantly affect the quality of business decisions in micro entities.

In accordance with the research objectives the main hypothesis of the paper is defined as follows.

Hypothesis 1: The simplification of accounting regulations for small businesses will reduce the cost of preparation of financial statements, which will not significantly affect the quality of information for decision-making.

The study included 271 companies. Most of the companies whose representatives participated in the survey are limited liability companies (83.8%) and 3.3% are companies with public accountability. Companies whose employees were engaged in the research are in 86% classified as small, and 14% as medium-sized entities.

The research results (Figure 1) prove that Croatian SMEs consider that accounting regulation for micro entities (fewer than 10 employees) should be significantly simplified (37% of the respondents generally agree with the above statement, while 31% of them fully support it). Also, the small entities (average score 3.65) gave an affirmative answer more often than the medium entities (average score 3.56).

Respondents were offered the potential simplifications of regulation for micro entities in accordance with the adopted amendment of IV. EU Directive. Results are shown in Figure 2. Most of the respondents (71%) believe that the exclusion from the public disclosure of financial statements, as well as reducing the requirement to disclose information in the notes will influence the cost reduction. More than 25% of the respondents consider it would significantly reduce the cost. These results are consistent with the results of the Department for Business Innovation and Skills about the UK implementation of the Micros-Exemption (Department for Business Innovation and Skills, 2013). Owners are usually also managers of micro entities and it seems that the publication of financial statements, as a tool of communication between the shareholders and management, loses its meaning as was shown by 68% of the respondents who stated that the exclusion from public disclosure of financial statements also contributed to entities' costs reduction. On the other hand, about one-fifth of the respondents believe that all noted simplifications would not affect the entities' costs.

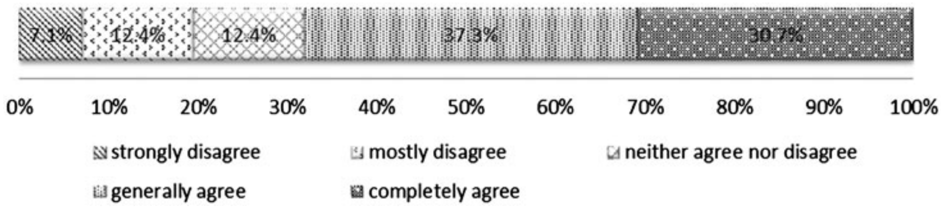

Figure 1. Necessity to simplify regulations for micro entities – respondents' opinions.
Source: Authors' calculation.

Furthermore, on a scale of 1 to 5, the respondents rated the claim that the noted simplifications will not significantly diminish the information quality used in the decision-making process of micro entities: the respondents generally agree with the statement, as shown by an average score of 3.64 (see Figure 1).

Certain methods of nonparametric statistics were used in order to test the hypothesis. The calculation of chi-square tests of differences in frequency response was based on the responses to the questions about whether respondents agree with the statement that accounting rules should be significantly simplified for micro entities, and on the frequencies of estimates how certain types of simplification would reduce the financial statements preparation costs.

First chi-square test (Table 5) examined whether there is a difference in the responses between those respondents who agree and those who disagree with the statement that accounting rules for micro entities need to be significantly simplified in relation to the abridged financial statements preparation and cost reduction.The frequencies of individual respondents' answers are presented in Table 5.

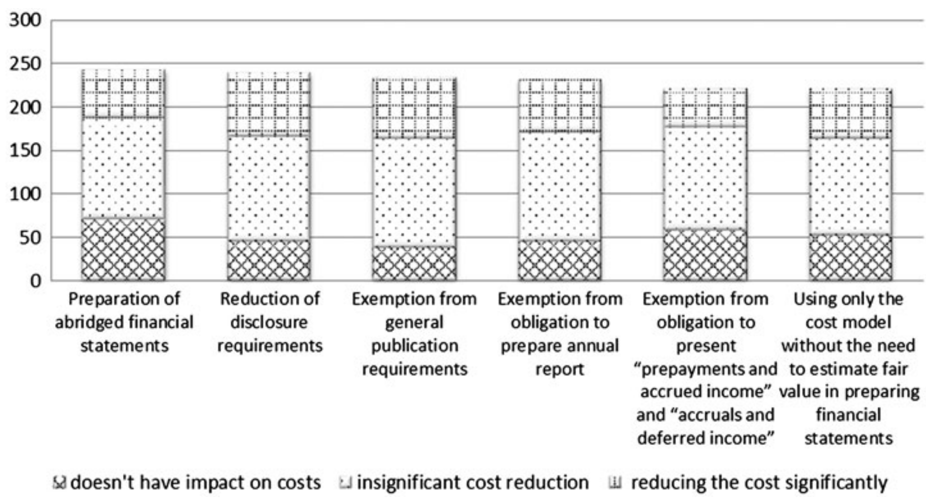

Figure 2. The influence of the proposed simplifications in financial reporting on the cost reduction – respondents' opinions.
Source: Authors' calculation.

Table 5. Chi-square tests of differences between respondents who agree and disagree with the statement that accounting rules should be simplified for micro entities ($N = 271$).

The preparation of abridged financial statements	Chi-square value	df	*P*
Chi-square test	24,372[a]	2	0.000
Number of responses	235		
The reduction of disclosure requirements	**Chi-square value**	**df**	***P***
Chi-square test	26,222[a]	2	0.000
Number of responses	231		
Exemption from general publication requirements	**Chi-square value**	**df**	***P***
Chi-square test	12,170[a]	2	0.002
Number of responses	228		
Exemption from obligation to prepare annual report	**Chi-square value**	**df**	***P***
Chi-square test	16,143[a]	2	0.000
Number of responses	226		
Exemption from obligation to present 'prepayments and accrued income' and 'accruals and deferred income'	**Chi-square value**	**df**	***P***
Chi-square test	9,066[a]	2	0.011
Number of responses	217		
Cost model application without the estimation of fair value in financial statements preparation	**Chi-square value**	**df**	***P***
Chi-square test	10,414[a]	2	0.005
Number of responses	217		

Source: Authors' calculation based on empirical research results.

The research results show that the difference between the respondents who differed in attitude towards simplification of accounting regulations related to the assessment of how the financial statements simplification (in the form of abridged financial statements) would affect the cost reduction of financial statements preparation, is statistically significant at a significance level less than 1% ($\chi^2 = 24.372$, $df = 2$, $p = 0.000$). The respondents who agree with the simplifications, more often consider that the preparation of abridged financial statements would lead to significant cost reduction. *P*-values are also lower than 1% for all other analysed simplifications. Therefore, all the above-mentioned arguments speak in favour of a complete confirmation of the first part of the hypothesis, which assumes that the simplification of accounting regulations for small businesses would reduce the costs of financial statements preparation. Except for confirmation of the first part of the hypothesis, that the simplification of financial reporting regulations reduces the financial statements preparation costs, it is necessary to prove or disprove that these simplifications will not significantly impair the quality of information used in decision-making in micro entities.

Concerning the hypothesis testing, chi-square tests were calculated (Table 6) to explore if there are statistically significant differences between the respondents who agree and those who disagree that specific simplification in regulation would affect the cost reduction with the statement that simplification would affect the quality of the information base for decision-making in micro entities.

The results of first chi-square test show that, among the respondents who believe that the preparation of abridged financial statements would have an effect on financial costs and those who do not agree with this thesis, there was no statistically significant differences in the frequencies of answers in which they agree with the statement: ‘The noted simplifications will not significantly impair the quality of information base for business decision-making in micro entities’ (χ^2=3.713, df = 2, p = 0.156). The same conclusion can be reached for the responses regarding the reduction in the disclosure requirements (χ^2=2.627, df = 2, p = 0.269) as well as for the exemption from the calculation and presentation of accruals and deferrals in financial statements (χ^2=3.931, df = 2, p = 0.140). Due to the fact that there are no statistically significant differences in the frequencies with which the respondents agree with the thesis that the simplifications will not significantly diminish the quality of the information base for decision-making in micro entities, thehypothesis for the previous three cases cannot be confirmed.

Table 6. Chi-square tests about statistically significant differences between the respondents who agree and those who disagree that specific simplification in regulation would affect the cost reduction with the statement that simplification would affect the quality of the information base for decision-making in micro entities (N=271).

The preparation of abridged financial statements	Chi-square value	df	*P*
Chi-square test	3,713[a]	2	0.156
Number of responses	227		
Reduction of disclosure requirements	Chi-square value	df	*P*
Chi-square test	2,627[a]	2	0.269
Number of responses	224		
Exemption from general publication requirements	Chi-square value	df	*P*
Chi-square test	7,891[a]	2	0.019
Number of responses	221		
Exemption from obligation to prepare annual report	Chi-square value	df	*P*
Chi-square test	5,640[a]	2	0.060
Number of responses	219		
Exemption from obligation to present ‘prepayments and accrued income’ and ‘accruals and deferred income’	Chi-square value	df	*P*
Chi-square test	3,931[a]	2	0.140
Number of responses	211		
Cost model application without the estimation of fair value in financial statements preparation	Chi-square value	df	*P*
Chi-square test	5,895[a]	2	0.052
Number of responses	211		

Source: Authors’ calculation based on empirical research results.

On the other hand, among respondents who believe that the exclusion from the public disclosure of financial statements affected the financial costs and those who do not agree with this thesis, the research results show that there is a statistically significant difference in the frequencies with which they agree with the proposed thesis (χ^2=7.891, df = 2, p = 0.019). In other words, the respondents who believe that the exclusion from the public disclosure of the financial statements affects the costs, more often agree with the thesis that the same kind of simplification will not significantly impair the quality of the information base. So, in this case, the hypothesis is confirmed.

Additionally, the responses between the respondents who believe that the exemption from the obligation of annual report preparation would influence the entities' costs and those who do not agree with this thesis were observed. Again, a statistically significant difference in the frequency with which respondents agree with the thesis that the quality of the information base for decision-making in micro entities will not be significantly reduced at the significance level of 6%, was confirmed. Although the traditional boundary of statistical significance is 5%, there is only a 1% difference in the risk of a wrong conclusion regarding why this difference can be interpreted as significant (χ^2=5.640, df = 2, p = 0.060). Namely, the respondents who believe that an exemption from the preparation of annual reports would affect the entities' costs, more often agree with the thesis that this simplification would not significantly impair the quality of the information base. Therefore, in this case, the hypothesis was confirmed.

Finally, the last simplification - the application of cost model as the only prescribed method (where fair value method is forbidden) represents the simplification which showed that there was a statistically significant difference between the respondents at the level of 5.2%. Taking into account that there is only a 0.2% difference in the risk of wrong conclusions, this difference can be interpreted as significant (χ^2=5.895, df = 2, p = 0.052). The respondents who believe that application of a cost model without fair value in financial statements preparation affects the costs, more often agree with the thesis that the same kind of simplification will not significantly impair the quality of information base, and the hypothesis in this case can be confirmed too.

In the end, it can be concluded that the hypothesis that claims that the simplification of accounting regulations for small businesses will reduce the costs of financial statements preparation and will not significantly reduce the quality of the information base for decision-making, is confirmed in all the most important simplifications.

5. Conclusion

During recent years, certain progress in the simplification of financial reporting regulation for SMEs has been achieved. The adoption of a European Commission suggestion would enable the exemption of small businesses from the audit of financial statements as well as the preparation of annual report. Furthermore, small groups would also be exempted from the preparation of consolidated financial statements. In this paper, special attention is given to the proposals for the simplification of accounting regulations for micro entities. Micro entities mainly operate locally, employing few employees, and management and ownership overlap in the same person. Therefore further significant simplification of regulations is necessary. This statement has been confirmed by the results of the study conducted in the Republic of Croatia. The exemption of micro enterprises from the public disclosure of financial statements in terms of the cost seems justified. However, the collection of business data for statistical and other purposes would arise as a problem. Furthermore, the results indicate the need for further reduction of requirements for disclosure information in the notes to the financial statements because this also creates additional costs for micro entities. The most important users of micro entities' financial statements are owners and banks. It is interesting that banks very often tend to look for specific calculations, primarily cash budgets, in order to analyse the creditworthiness of the clients. As a consequence, the reduction of disclosure requirements may contribute to the reduction of a regulatory burden for micro entities. In this paper, certain scientific research methods were applied to test the hypothesis regarding the simplification of accounting regulations for micro entities. The results confirmed that this simplification results in the cost reduction of preparing the financial statements. Nevertheless, the simplification does not significantly decrease the quality of the information used for decision-making.

In conclusion, it can be noted that the theory and practice confirmed the need for additional simplification of accounting regulations for the smallest entities – micro entities. The micro entity as a category in the financial reporting sense has not yet been formally recognised in Croatia. Hence, it is very likely that some amendments of national accounting legislation in accordance to the European Commission provisions of the new Accounting Directive issued in June 2013 will occur. It is possible to assume that the potential changes will have a positive effect on the development of our micro entities.

Disclosure statement

No potential conflict of interest was reported by the authors.

Note

1. The target population is comprised of small- and medium-sized entities whose primary activity is manufacture and trade, i.e. that are according to the National Classification of Activities in 2007 classified in area C – manufacturing, G – retail and wholesale. Respondents were owners/managers as well as accountants employed in small- and medium-sized enterprises in the Republic of Croatia. In the research period 422 responses were collected. However, after elimination of incomplete surveys or questionnaires that did not meet the defined criteria, the final number of properly completed questionnaires is 271.

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