A SURVEY OF SOUTH AFRICAN REGISTERED ACCOUNTANTS' AND AUDITORS' ATTITUDES TOWARDS DIFFERENTIAL CORPORATE REPORTING

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A Survey of South African Registered Accountants' and Auditors' Attitudes Towards Differential Corporate Reporting

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ABSTRACT

The aim of this dissertation is to investigate aspects of the differential corporate reporting debate in South Africa. The dissertation summarises the background to the current position and findings in respect of all previous South African research and selected previous international research. The dissertation reports the results of a postal survey of South African registered accountants' and auditors' perceptions of the suitability of selected South African statements of generally accepted accounting practice to a range of South African entities varied by size, legal form and financial statement user base. The dissertation provides evidence of (i) the need for differential corporate reporting in South Africa, (ii) the need for multiple differential reporting thresholds in South Africa, and (iii) the need for differential reporting options to include both presentation and disclosure and recognition and measurement concessions. The dissertation also raises some questions for future research.

DECLARATION

I hereby declare that this dissertation is entirely my own work.

Michael John Cuthbert Wells

23/12/2004

Date

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LIST OF ABBREVIATIONS

AARF	Australian Accounting Research Foundation
AcSB	Canadian Accounting Standards Board
AICPA	American Institute of Certified Public Accountants
AGM	Annual general meeting
CICA	Canadian Institute of Chartered Accountants
DP SME	Discussion paper - Preliminary views on accounting standards for small and medium-sized entities (International Accounting Standards Board)
DRAC	Differential Reporting advisory Committee (Canada)
DTI	The Department of Trade and Industry (South Africa)
EFRAG	European Financial Reporting Advisory Group
FASB	Financial Accounting Standards Board
FRSSE	Financial reporting standard for smaller enterprises (United Kingdom)
GAAP	General purpose financial reporting standards
IASB	International Accounting Standards Board
IASB SME Standards	Standards for small and medium-sized entities (IASB)
IASC	International Accounting Standards Committee
IASCF	International Accounting Standards Committee Foundation
ICAEW	Institute of Chartered Accountants in England and Wales
ICANZ	Institute of Chartered Accountants of New Zealand
IFRS	International financial reporting standards
ISAR	The United Nations Intergovernmental Working Group on International Standards of Accounting and Reporting
JSE	JSE Securities Exchange
LPFRS	Limited purpose financial reporting standards
PAAB	Public Accountants' and Auditors' Board (South Africa)
SAICA	The South African Institute of Chartered Accountants
SA GAAP	South African statements of generally accepted accounting practice
SARS	South African Revenue Services
SBEs	Small business enterprises (Canada)
SMEs	Small and medium-sized entities (International)
UK	United Kingdom
UK GAAP	General purpose financial reporting standards (England and Wales)
USA	United States of America
US GAAP	General purpose financial reporting standards (USA)

Chapter 1

INTRODUCTION

1.1 Background to the study

Codified financial reporting is a relatively new practice and almost every aspect of it, including even its broad classification as a science or an art, remains the subject of debate (Wolk, Tearney & Dodd,2001:38).

The invention of the double-entry system of bookkeeping from which western financial reporting evolved, and upon which substantial aspects of it are still based, is generally accepted to have originated by Pacioli in Italy during the thirteenth century (Nobes,1999:11). Although the double-entry system of bookkeeping is similar universally (Nobes & Parker,1998:15), the recognition, measurement and disclosure requirements of different countries vary widely.

Nobes and Parker (1998:4) identify Scotland, in 1854, as the first western country to have a professional accountancy body, and credit Britain with leading accounting matters during the nineteenth century, followed by the United States of America (USA) in the twentieth century.

The USA's Financial Accounting Standards Board (FASB) is accredited as being the first standard-setting body to develop a conceptual framework which it worked on continuously for a decade (Nobes & Parker,1998:134). Wolk *et al* (2001:208) refer to FASB's conceptual framework as an attempt to provide a metatheoretical structure for financial accounting. The FASB's framework has been influential around the world, as evidenced by the International Accounting Standards Committee's (IASC) framework and the United Kingdom's (UK) statement of principles clearly being derived therefrom (134).

The IASC was founded in 1973 (Nobes & Parker,1998:70) with the focussed intention of harmonising accounting practices internationally. Nobes and Parker (13) justify studies of comparative accounting on the increasing global nature of financial markets, business enterprises and accounting firms. These reasons underpin the necessity for a single set of global general purpose financial reporting standards. The IASC issued international accounting standards that mostly closely followed or compromised between US GAAP and UK GAAP (71). In 2001, the International Accounting Standards Board (IASB) succeeded the IASC (IASB,2004a:13). Global financial reporting harmonisation efforts have greatly intensified in

the twenty-first century, with many western countries requiring compliance with IFRS with effect from 2005, for example, European Union securities exchange listed domestic companies (IASB,2004b). Research conducted by Deloitte Touche Tohmatsu during 2004 found that ninety-two countries either permit or require the use of the international financial reporting standards (IFRS) issued by the IASB by all or some domestically listed companies by 2007 (IASB,2004a:iv). Further, the US GAAP-IFRS harmonisation efforts have greatly intensified. This should lead to a universal unitary set of codified general purpose financial reporting standards in the foreseeable future.

To satisfy the twenty-first century information needs of divergent broadly based user groups, many of whom are not in a position to demand additional information from the entity, general purpose financial reporting standards (GAAP) are necessarily complex and increasingly voluminous. It is widely acknowledged both in South Africa (Hattingh,1999:21, 2001:23, 2002a:29, 2002b:24; Institute of Directors in South Africa,2002:126) and internationally (Hepp & McRae,1982:52; Holmes, Kent & Downey,1991:125; Baskerville & Simpkins,1997:14; Mersereau,2002:30) that such reporting requirements are not necessarily appropriate to all entities. Compliance with GAAP can result in substantial costs being incurred by the reporting entity without sufficient benefit, if any, for the users of the financial statements. For this reason, some jurisdictions have established differential corporate reporting requirements whereby qualifying entities are permitted to apply less onerous requirements in the preparation of their financial statements. However, the differential corporate reporting requirements of different jurisdictions vary greatly not only in the determination of which entities qualify to apply lesser requirements, but also in the form and content of the lesser reporting requirements. Further, there remains considerable dissatisfaction with the existing differential reporting requirements of some jurisdictions, for example, McAleese (2001), and the current differential reporting proposals of others, for example, Everingham & Watson (2003). The differential reporting requirements of different jurisdictions around the world are analysed in chapter 4.

In South Africa, the issue of differential corporate reporting is relatively new with very little empirical research having been undertaken. The South African government is currently considering the implementation of differential corporate reporting requirements (SAICA,2002a) and the SAICA is in the process of developing limited purpose financial reporting standards (LPFRS) to provide for the implementation of differential corporate reporting in South Africa (SAICA,2003a). In view of the lack of local research, this study aims to provide the initial research into the desirability of differential corporate reporting in South Africa, with particular emphasis on the theoretical background to the subject and the opinions of public accountants towards (i) the appropriate threshold for differential reporting, (ii) the form that differential

corporate reporting requirements should take, and (iii) limited aspects of the detail requirements of LPFRS.

1.2 Motivation and purpose of the study

Although differential corporate reporting is currently practised to some extent in South Africa, that is, the reporting requirements for securities exchange listed companies are more onerous than those for unlisted companies (JSE,2003; SAICA,1998a:4, 1998b:2) which in turn are more onerous that those for close corporations (SAICA,2001a:para76), there is much dissatisfaction with the existing requirements that are currently under review (Hattingh,1999:21, 2001:23, 2002a:29, 2002b:24; Institute of Directors in South Africa,2002:126; DTI,2004). Further the current review is being undertaken in the absence of significant empirical domestic investigations into the desirability, threshold, form and content that such South African differential corporate reporting requirements should take. In the light of international research and experimentation with differential corporate reporting, this study attempts to provide some South African research that may be useful to (i) the authorities in determining which entities, if any, should qualify for lesser reporting requirements and (ii) the SAICA in determining the reporting requirements of limited purpose financial reporting standards. To achieve these objectives the study is conducted in two parts.

The first part of this study reviews published key international and all known local research and establishes the current differential reporting practices globally. This provides a basis against which current South African differential reporting practices and proposals can be evaluated and provides much input to the questionnaire-based phase of this study.

The second part of this study empirically investigates the desirability, threshold, form and aspects of the content of differential corporate reporting. The investigation takes the form of an opinion survey, via postal questionnaire, of the attitudes of registered accountants and auditors towards aspects of differential corporate reporting. It is intended that the results of this part of the study will provide insight into the need for differential corporate reporting in South Africa and provide a basis for further South African research. Further, the results of this study should assist the South African authorities and standards-setters in determining (i) the threshold/s for differential corporate reporting; (ii) the form/s that it should take; and (iii) some aspects of its detailed reporting requirements.

1.3 Importance of the research

On a national level, this research is important as it aims to contribute to the successful implementation of differential corporate reporting in South Africa. Optimum differential reporting requirements eliminate the reporting of information where the costs of reporting exceed the benefits to be derived from that information. Differential reporting has the potential to contribute to the competitiveness of South African business. This is particularly relevant to small and medium-sized entities (SMEs), as the South African government has identified SMEs as a significant source of future economic growth and unemployment reduction.

On a professional level, this research brings together the findings of relevant prior studies and contributes to the body of knowledge on the subject by providing a detailed study of various aspects of differential corporate reporting in the South African context.

1.4 Research approach

To implement the research objectives set out above, two research methods were employed, namely, archival research and survey research.

The archival research undertaken in this study is presented in chapters 2 to 4. First, primary data sources relevant to South African existing and proposed differential corporate reporting requirements were reviewed. These included, relevant laws, draft laws, standard-setter pronouncements and draft standard-setter pronouncements. This was followed by a review of primary data sources relevant to the current differential reporting practices of key standard-setting nations and the IASB. These included, relevant laws and standard-setter pronouncements. Finally, secondary data sources including, all known local and key international differential reporting studies, were reviewed.

The survey research component of this study is reported upon in chapters 5 to 7. The survey research was implemented by means of a postal questionnaire that tested the opinions of public accountants toward key aspects of differential corporate reporting including desirability, threshold, form and content.

1.5 Organisation of the study

This study is structured in 7 chapters, as follows:

Chapter 1: Introduction

This chapter sets out the background to the research topic, the motivation and purpose of the study, the importance of the research, the research approach and the organisation of the study.

Chapter 2: South African corporate reporting: the status quo

This chapter sets out the current reporting requirements in respect of the various forms of South African corporate entities. The purpose for which such financial statements are produced and the form that they are required to take is also examined.

Chapter 3: South African corporate reporting: future proposals

This chapter sets out the current South African differential corporate reporting proposals.

Chapter 4: Literature review

This chapter establishes current international differential reporting practices and discusses prior key international and all prior South African differential corporate reporting research studies.

Chapter 5: Research methodology

This chapter describes the methodology employed in this research study. This includes discussion of (i) the research objectives, questions and hypotheses, (ii) selection of the target group, (iii) research design and sampling, (iv) the measuring instrument, (v) distribution of questionnaires, (vi) response rate, (vii) data preparation, processing and analysis, and (viii) limitations of the research.

Chapter 6: Research findings

This chapter presents the findings of the research conducted in this study and analyses and evaluates the research findings in the light of the pre-existing body of knowledge on differential corporate reporting.

Chapter 7: Conclusions and recommendations

This chapter presents a summary of this research including conclusions and recommendations and makes some suggestions for future research.

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Chapter 2

SOUTH AFRICAN CORPORATE REPORTING: THE STATUS QUO

2.1 Introduction

This chapter identifies the range of corporate entities relevant to this study, and the existing requirements in accordance with which each category of corporate entity is required to prepare its financial statements. The purpose and form of the financial statements statutorily required for each relevant category of corporate entity is also established. From these existing reporting requirements, the current extent of differential corporate reporting provisions in South Africa can be established. This chapter therefore provides the legal framework within which South African corporate reporting is currently taking place, and therefore constitutes an essential building block in the research process of this study.

2.2 South African corporate entities

South Africa corporate entities take the legal form of close corporations and private companies and public companies (DTI,2004:16). Under South African law, that is, the Companies Act and the Close Corporations Act, the three corporate entity forms identified are differentiated primarily with respect to membership and the ease with which their equity and debt instruments can be traded. The differentiating characteristics of South African corporate entity forms are set out in table 2-1.

Corporate financial reporting in South African is regulated by statute and in some cases also by other regulatory bodies, for example, a public company that is listed on the JSE Securities Exchange is subject to its listing requirements. As a range of statutes and regulatory bodies govern South African corporate reporting, it is necessary to establish the reporting requirements for each of the three corporate entity forms. In South African law, little distinction is made between the reporting requirements of public and private companies (DTI,2004:16). However, the gap between the reporting requirements of companies and close corporations is large (DTI,2004:17). An overview of differences between the structure and reporting requirements of the South African corporate entity forms identified is set out in table 2-3. Table 2-4 provides a more detailed analysis of existing South African differential corporate reporting requirements.

Table 2-1 Characteristics				
	Close corporation	**Private company**	**Public company**	**JSE listed company**
Regulation	Close Corporations Act	Companies Act	Companies Act	Companies Act and securities exchange listing requirements
Regulatory environment	Largely self regulated and not subject to audit	Onerous administrative regime and subject to audit	Onerous administrative regime and subject to audit	Very onerous administrative regimes and subject to audit and public scrutiny
Separate legal persona	Yes	Yes	Yes	Yes
Separation of owners and management	Hardly ever	Not usually	Usually	Almost always
Maximum number of members	10	50	Unlimited	Unlimited
Nature of members	Limited to natural persons	Unlimited	Unlimited	Unlimited
Able to raise funds in a public forum	No	No	Yes, subject to stringent requirements	Yes
Able to repurchase own equity	Yes, subject to minor limitations	Yes, subject to minor limitations	Yes, subject to some limitations	Yes, subject to rigorous limitations

Table 2-2 Financial reporting requirements

	Close corporation	Private company	Public company	JSE listed company
Basis of preparation of annual financial statements (AFS)	gaap	gaap reconciled to SA GAAP	gaap reconciled to SA GAAP	SA GAAP or IFRS
Is compliance with the reporting requirements of the JSE required?	No	No	No	√
Are AFS subject to audit?	No	√	√	√
Are AFS available to the general public?	No	No	√	√
Are interim financial statements required?	No	No	†	√
Components of annual financial statements:				
• Balance sheet and notes	√	√	√	√
• Income statement and notes	√	√	√	√
• Statement of changes in equity and notes	*	√	√	√
• Cash flow statement and notes	#	√	√	√
• Directors' report	No	√	√	√
• Accounting officer's report	√	No	No	No
• Auditor's report	No	√	√	√

Key:

√ = Explicit requirement of an Act or other regulatory body.

* = Equivalent disclosures explicitly required (s58(2)(c)) of the Close Corporations Act.

= Where relevant to members' decisions, then indirectly required.

† = Explicitly required where the company has share capital, otherwise it is not required.

Table 2-3 Existing differential reporting requirements

	Close corporation	Private company	Public company	JSE listed company
Basis of preparation	gaap	gaap reconciled to SA GAAP	gaap reconciled to SA GAAP	SA GAAP or IFRS
Comparative figures	#	√	√	√
Consolidated financial statements	#	‡	‡	√
Earnings per share	No	No	No	√
Headline earnings per share	No	No	No	√
Segmental disclosures	No	No	No	√
Corporate governance disclosures	No	No	No	√
Other securities exchange listing requirements	No	No	No	√

Key:
√ = Explicitly required to report under an Act or binding regulatory authority.
= Where relevant to members' decisions, then indirectly required.
‡ = Explicitly required where the company has one or more subsidiaries, but limited exemptions apply.

2.3 The purpose of financial statements

The objective of general purpose financial statements is to provide information about the financial position, financial performance and cash flows of an entity that is useful to a wide range of users in making economic decisions (SAICA,1990:12). Financial statements also show the results of management's stewardship of the resources entrusted to it (SAICA,1990:14).

In the preliminary view of the International Accounting Standards Board (IASB), the objective of a set of financial reporting standards for small and medium-sized entities (SMEs) should be:

- to provide high quality, understandable and enforceable accounting standards suitable for SMEs globally;
- to focus on meeting the needs of users of SME financial statements;
- based on the same on the same conceptual framework as IFRSs; and
- to reduce the financial reporting burden on SMEs that want to use global standards (IASCF,2004:18).

Users of general purpose financial statements are assumed to have a reasonable knowledge of business, economic activities and accounting, and a willingness to study the information with reasonable diligence (SAICA,1990:para25). Users include investors, employees, lenders, suppliers, trade creditors, customers, governments and their agencies, and members of the general public (9). Financial statements, unless it is clearly stated to the contrary, are prepared on the underlying assumptions of: (i) the accrual basis, that is, the effects of transactions and other events are recognised when they occur rather than on a cash basis (para22); and (ii) going concern, that is, the enterprise will continue in operation for the foreseeable future (para23). Further, financial statements have four principal attributes that the make information provided in financial statements useful to users, namely, understandability, relevance, reliability, and comparability (para24).

In applying South African statements of generally accepted accounting practice (SA GAAP), consideration should be given to economic substance over legal form, and materiality (SAICA,1983:para11). The economic substance of transactions should be recorded where this differs from its legal form. The frame of reference for all materiality decisions must be based on the user (SAICA,1990:para30). Preparers therefore make materiality assessments on behalf of users. Accordingly, financial statements should disclose all items that are material enough to affect users' evaluations or decisions taken on the basis of the financial statements (SAICA,1983:para11).

Schedule 4 paragraph 4(v) to the Companies Act reads as follows, "Material means anything that is significant in relation to the circumstances applicable to each company; and materiality shall have a corresponding meaning." SAICA (1998c:para32) identifies two characteristics upon which materiality depends, namely, the size of the item and the nature of the item. The size and nature of the item must be considered together in determining the materiality of an item. Materiality does not impose financial reporting requirements of its own, but modifies other requirements that have arisen in response to other concepts. Specific disclosure requirements arising from SA GAAP need therefore not be met if the resulting information is not material.

Fair presentation is not defined in the Companies Act. It is referred to in s286(3) and also SAICA (1998c:para11). The overriding requirement of the Companies Act is fair presentation (SAICA,1983:para7). SAICA (1998c:para11) clarifies that the application of SA GAAP, with additional disclosure when necessary, is presumed to result in financial statements that achieve fair presentation. SAICA (2004a:para13) further clarifies that fair presentation requires the faithful representation of effects of transactions, other events and conditions in accordance with the definitions and recognition criteria of assets, liabilities, income and expenses set out in the framework.

Measurement involves selecting a basis of measurement for the recognition of elements that have passed both of the recognition criteria (SAICA,1990:para99). The more commonly sanctioned measurement bases are historical cost, fair value, and present value. It is common for a single enterprise to use more than one basis of measurement in the presentation of their financial statements. Individual financial reporting standards stipulate the measurement base required and sometimes permit a free choice between specified measurement bases. For example, SAICA (1999a) as well as SAICA (1999b) sanction both the cost model and the revaluation model, and SAICA (2000a) sanctions both the cost model and the fair value model. The eclectic mix of measurement models sanctioned by standard-setters impairs the usefulness of financial statements. The IASB is currently investigating accounting measurement (IASB,2002). This technical project may result in amendments to the framework.

2.4 Close corporations

Close corporations came into being in June 1984 when parliament passed the Close Corporations Act, No 69 of 1984 (SAICA,2001a:para01). The overriding intention of the Close Corporations Act is to provide a less complex and more easily administered separate legal entity through which business can be conducted (para03). Close corporations enable smaller undertakings to acquire a legal personality distinct from its members thus providing for limited liability and perpetual succession (para02) at a relatively low cost. Close corporations are intended to be self-regulating (para05) and consequently their financial statements are not required to be subject to audit. However, section 62 of the Close Corporations Act requires the accounting officer to: (i) determine that the annual financial statements of the close corporation are in agreement with its accounting records; and (ii) review the appropriateness of the stated accounting policies. The accounting officer may be a member or employee of the close corporation and is required to be a member of a recognised profession (s60).

Membership of a close corporation is limited to ten (s28) natural persons (s29). There is no separate board of directors and management is the responsibility of members who are all agents of the close corporation and have an equal right to participate in the running of the business (SAICA,2001a:para51). However, in accordance with section 46(b) of the Close Corporations Act, unless the association agreement provides otherwise, consent in writing of members holding at least seventy-five percent of the members' interest is required for: (i) any acquisition or disposal of immovable property by the corporation; (ii) change in the principal business of the corporation; or (iii) the disposal of all, or substantially all, of the corporation or its assets.

The combined effect of these factors limits the use of close corporations to the relatively small and closely-held operations for which they were intended.

A close corporation shall cause annual financial statements to be prepared that, in conformity with generally accepted accounting practice (gaap) appropriate to the business of the corporation, fairly present the state of affairs of the corporation at the end of the financial year and the results of its operations for that year (s58). The SAICA initially interpreted these reporting requirements to mean that close corporations should prepare their financial statements in accordance with SA GAAP but later relented on this issue (Hattingh,2002b:24). In 2001, the SAICA clarified that close corporations are required to prepare their financial statements in accordance with gaap rather than SA GAAP. In determining what constitutes gaap, account must be taken of the needs of the members of the close corporation who are also the primary users of the annual financial statements (SAICA,2001a:para74-75). Important needs of the members include managing, controlling and developing the business of the close corporation (75). Therefore, where GAAP and logic part way (Hattingh,2002a:29), close corporations may be justified in following appropriate gaap. Hattingh (2002c:27) claims to have identified 101 instances in which the application of SA GAAP would hinder an analyst's ability to assess the value of an entity from its SA GAAP compliant financial statements. The needs of the primary users may be better served by applying appropriate gaap in these circumstances. Some of the hindrances in SA GAAP to the analyst include fundamental issues that are at the very foundation of SA GAAP. In particular, Hattingh (2002c:27) identifies that the demise of the matching concept in favour of the definitions of an asset and a liability, as contained in the framework, as impeding the analyst's ability to assess maintainable earnings. By applying appropriate gaap in the presentation of their financial statements, close corporations can thus obviate the need for management accounting systems that are separate to their financial reporting systems.

The application of appropriate gaap by close corporations is thus consistent with both the purpose for which that entity form was enacted and the cost-benefit constraint that pervades financial reporting.

In accordance with section 58(2)(a) of the Close Corporations Act, annual financial statements shall consist of:

> "(i) a balance sheet and any notes thereon; and
> (ii) an income statement or any similar financial statement where such form is appropriate, and notes thereon."

Similar to the SA GAAP requirement to prepare a statement of changes in equity, section 58(2)(c) of the Close Corporations Act requires specific items relating to the equity of the close corporation to be disclosed in close corporation financial statements, in aggregate amounts at balance sheet date and movements therein for the year, namely:

- contributions by members,
- undrawn profits,
- revaluations of fixed assets, and
- loans to or from the members.

The absence of explicit requirements to present a cash flow statement and comparative figures does not suggest that it is inappropriate for a close corporation to present that information. In many instances, the needs of the members would be well served by the presentation of such information in a manner that fairly presents the state of affairs of the close corporation. In such cases, presentation of that information falls within the ambit of gaap for the affected close corporation and therefore should be presented in its annual financial statements.

Section 58(2)(e) of the Close Corporations Act requires that the annual financial statements of a close corporation contain the report of the accounting officer. In accordance with section 62(c), the accounting officer is required to report whether the annual financial statements of the close corporation are in agreement with its accounting records and whether the stated accounting policies of the close corporation are appropriate to the business of the close corporation. Where the accounting policies of a close corporation apply gaap, rather than SA GAAP, the accounting officer may need to apply considerable judgement in reporting on the appropriateness of the close corporation's accounting policies.

While the South African Department of Trade and Industry (DTI) recognise that close corporations offer a viable alternative for smaller businesses, they perceive it to be too highly formalistic a business vehicle for unsophisticated entrepreneurs to commence business for the first time and to ensure effective management (DTI,2004:17). Consequently, the DTI proposes that close corporations be abolished (29).

2.5 Companies

South African companies are incorporated under the Companies Act No 61 of 1973. Section 19 of the Companies Act essentially provides for two types of companies having share capital, namely private companies and public companies. Companies not having a share capital are deemed to be public companies for the purposes of the Companies Act. Although the requirements of the Companies Act apply to all public companies, public companies can further be analysed into those that are listed on one or more securities exchanges and those that are not. This differentiation is justified as listed public companies are further regulated by the securities exchanges on which their equity and debt instruments are traded.

Companies have a separate legal persona to their shareholders but unlike close corporations are frequently not actively managed by their members. The separation of management from owners necessitates onerous administration procedures and structures in respect of companies. Sections 170 to 207 of the Companies Act set out administrative requirements. Sections 208 to 251 set out requirements in respect of directors. Sections 252 to 268 set out remedies available to members where they feel aggrieved by the actions of directors. Sections 427 to 440 are relevant only to companies under judicial management.

Companies are subject to a statutory audit. Sections 269 to 283 of the Companies Act detail the requirements for the appointment, removal, rights and duties of auditors. Section 275(g) requires the company's auditors be registered under the Public Accountants' and Auditors' Act. Sections 284 to 309 are most relevant to this dissertation as they detail the accounting and disclosure requirements. Sections 300 and 301 require that the external auditor audit and report on the company and group annual financial statements.

Reporting requirements for South African companies are more complex than those in respect of close corporations. In accordance with section 286 of the Companies Act, the directors of a company shall cause annual financial statements to be prepared in conformity with generally accepted accounting practice that fairly present the state of affairs of the company at the end of the financial year, and the profit or loss of the company for that financial year. Legal opinion

sought by the SAICA has interpreted the requirements of section 286 to be satisfied in all cases where financial statements are prepared in accordance with SA GAAP (SAICA,1999c:para04). However, senior counsel also found that the requirements of section 286 may also be satisfied where financial statements are prepared in accordance with gaap (para04).

In accordance with section 286(3) of the Companies Act, the financial statements of a company must include at least the matters prescribed by Schedule 4. Paragraph 5 of Schedule 4 provides:

> "If it appears to the directors of a company that there is reason for departing from any of the accounting concepts stated in Statements of Generally Accepted Accounting Practice approved by the Accounting Practices Board, where such appropriate Statements exist, in preparing the company's financial statements in respect of any accounting period they may do so, but particulars of the departure, the effects and reasons for it shall be given".

Legal opinion obtained from senior counsel by the SAICA during September 1999 interpreted the accounting concepts referred to in paragraph 5 of Schedule 4 to be the detailed requirements of SA GAAP (SAICA,1999c:para06). This may mean that those companies that choose to prepare their financial statements in accordance with gaap should provide a reconciliation of that gaap to SA GAAP.

SA GAAP requires an entity whose financial statements comply with all the requirements of SA GAAP to make an explicit and unreserved statement of such compliance (SAICA,1998c:para12). Further, entities whose financial statements do not comply with all the requirements of SA GAAP are prohibited from described their financial statements as being compliant with SA GAAP. This disclosure that is presented as the first note to the financial statements (para105) assists users in identifying whether the entity has applied SA GAAP or gaap.

In accordance with section 286(2) of the Companies Act, annual financial statements shall consist of:

" (a) a balance sheet, including any notes thereon or documents annexed thereto providing information required by this Act;
(b) an income statement, including any similar financial statement where such form is appropriate and including any notes thereon or document annexed thereto providing information required by this Act;
(bA) a cash flow statement;
(c) a directors' report complying with the requirements of this Act; and
(d) an auditor's report as required by section 301".

The first three requirements of the Companies Act are in common with those of SAICA (1998c), that is, AC 101. However, AC 101 adds a statement of changes in equity to the

composition of a complete set of financial statements (para8) and provides detailed guidance on the structure and content of financial statements (paras43-103). Irrespective of whether a company's financial statements are prepared in compliance with gaap or SA GAAP, all companies are required to present all of the components of financial statements identified.

2.5.1 Private companies

Section 20 of the Companies Act limits membership of a private company, excluding employees and certain past employees, to fifty. Private companies are prohibited from making an offer to the public for the subscription of any shares or debentures of the company (s20). These restrictions do not necessarily limit the size, other than membership, of private companies, particularly as unlike close corporations, they may have corporate members and therefore frequently are subsidiaries of domestic and foreign public companies.

2.5.2 Public companies

Public companies vary greatly in size and nature of membership and operations. Public companies include associations not for gain and multiple securities exchange listed multinational corporations. Section 21 of the Companies Act requires associations not for gain to have as their main objective the promotion of religion, arts, sciences, education, charity, recreation, or any other cultural or social activity or communal or group interests, and to apply their profits to that main objective without the option of distributing a dividend to their members. Associations not for gain vary greatly in size, from small interest groups to multinational charities. Multiple exchange listed multinational corporations generally aim to maximise the wealth of their internationally diversified shareholder base.

There are no numeric restrictions on the membership of a public company and their securities may be listed on one or more securities exchanges.

2.5.3 Securities exchange listed companies

Where public companies list their securities on one or more securities exchanges, they become subject to the requirements of the securities exchange/s on which they are listed. These securities exchange requirements are in addition to the requirements of the Companies Act.

Companies with a primary listing on the JSE Securities Exchange (JSE) are, in accordance with listing requirement 8.62(b), required to prepare their financial statements in accordance with either SA GAAP or IFRS (JSE,2003). Current SA GAAP is almost completely harmonised with IFRS and is currently in the process of being totally harmonised therewith (SAICA,2003b). With effect from 2005, the JSE will withdraw the SA GAAP alternative in favour of the exclusive application of IFRS (para3). As SA GAAP will, except for the 500 series of South African statements and interpretations, be identical to IFRS by 2005, this amendment is almost entirely inconsequential. Section 8 of the listing requirements of the JSE imposes many additional disclosure requirements on affected companies. Of particular interest are the requirements in respect of headline earnings per share, corporate governance and related parties.

JSE listing requirement 8.63(a) requires affected entities to make the following corporate governance disclosures in their annual financial statements:

(i) a narrative statement of how it has applied the principles set out in the code of corporate practice and conduct, as set out in the King report on corporate governance, providing explanation(s) that enable(s) its shareholders to evaluate how the principles have been applied; and

(ii) a statement addressing the extent of the company's compliance with the King code and the reasons for non-compliance with any of the principles in the code, specifying whether or not the company has complied throughout the accounting period with all the provisions of the King code, and indicating for what part of the period any non-compliance occurred.

Further, the JSE listing requirements require compliance with, including disclosure of compliance therewith in the annual financial statements, the following:

s3.84(a) There must be a policy detailing the procedures for appointments to the board. The procedures for the appointment of directors must be formal and transparent and a matter for the board as a whole; where appropriate, a nomination committee should be used. The nomination committee must constitute only non-executive directors, the majority of which must be independent directors and should be chaired by the board chairperson.

s3.84(b) There must be a policy evidencing a clear division of responsibilities at board level to ensure a balance of power and authority, such that no one individual has unfettered powers.

s3.84(c) The chief executive officer must not also hold the position of chairperson.

s3.84(d) Issuers must, in compliance with the King code, appoint and disclose in the annual financial statements, the composition of, a brief description of their mandates, the number of meetings held, and other relevant information in respect of the following committees:

- audit committee
- remuneration committee
- risk committee (if required by the nature of the business)
- nomination committee (if required by the nature of the business and composition of the board).

s3.84(e) A brief *curriculum vitae* of each director standing for election or re-election at the annual general meeting (AGM) should accompany the notice of the AGM contained in the annual financial statements.

s3.84(f) The capacity of each of the directors should be categorised as follows:

- Executive director;
- Non-executive director; or
- Independent director.

s3.84(l) Detailed disclosures of directors' emoluments on an individual basis.

Companies that have only their secondary listing on the JSE, generally follow the listing requirements of the exchange on which the primary listing resides ahead of those of the JSE. However, the JSE reserves the right to instruct the issuer to comply with certain sections of, or in full with, its listing requirements (s18.1). Consequently, annual financial statements must state where the primary and secondary listings of the entity's securities reside (s18.2) and companies whose secondary listing resides on the JSE and whose accounting practices are not in accordance with Section 8 - Financial information of the JSE listing requirements, must consult the JSE in order to obtain a ruling concerning what constitutes an acceptable accounting practice and disclosure. However, in all cases the requirements of SAICA (2002b), that is, Circular 7/2002 - Headline earnings, must be complied with (s18.5).

Dual listed companies structure applies to an aggregated group with combined businesses accounted for under two separately listed companies:

- one company housing the South African based businesses with its primary listing on the JSE; and

- another company housing the foreign businesses with its primary listing on another stock exchange acceptable to the JSE and its secondary listing on the JSE.

The two companies together form the dual listed company structure. The dual listed company must:

- where the listing requirements of the two stock exchanges are in conflict, comply with the more stringent stock exchange's requirements (s18.15, s18.25);
- publish aggregated annual financial statements, that is, in effect consolidated financial statements, in accordance with SA GAAP or IFRS, failing which a comprehensive reconciliation to SA GAAP or IFRS must be published and presented in rands. The annual financial statements of the individual companies may be published as supplementary information to the aggregated accounts (s18.21); and
- publish aggregated interim financial information on an equivalent basis (as set out above) to that on which it publishes its aggregated and separate company annual financial statements (s18.22).

2.6 Differential reporting in SA GAAP

Current SA GAAP and the IFRS from which they are cloned, already contain some differential reporting provisions. Entities whose equity or debt securities are not publicly traded, or in the process of becoming publicly traded, are exempt from the requirements of AC 115 - Segment reporting, that is, they are not required to present segmental information (SAICA,1998a:para3) and the requirements of AC 104 - Earnings per share, that is, they are not required to present earnings per share (SAICA,1998b:para2).

The scope of AC 127 - Interim financial reporting, does not mandate which entities should prepare interim financial statements (SAICA,1998d:para1). In accordance with section 303 of the Companies Act, South African public companies that have share capital other than wholly-owned subsidiaries, are required to prepare half-yearly interim financial statements. Therefore, public companies without share capital and all private companies are not required to prepare interim financial statements. As South African public companies that have share capital are not necessarily listed on a securities exchange, this differential corporate reporting requirement is not unique to listed companies as unlisted public companies that have share capital are also required to present interim financial statements.

In accordance with a December 2003 revision to IAS 27 (AC 132) - Consolidated and separate financial statements, a parent need not present consolidated financial statements if, and only if all of the following conditions are satisfied (SAICA,2004b:para10):

- the parent is a wholly owned subsidiary, or is a partially-owned subsidiary of another entity and its other owners, including those not otherwise entitled to vote, have been informed about, and do not object to, the parent not presenting consolidated financial statements;
- the parent's debt or equity instruments are not traded in a public market;
- the parent did not file, nor is it in the process of filing, its financial statements with a securities commission or other regulatory organisation for the purpose of issuing any class of instrument in a public market; and
- the ultimate or any intermediate parent of the parent produces consolidated financial statements available for public use that comply with international financial reporting standards.

These complex exemption rules are entity specific and do not necessarily result in all private companies being exempt from the requirement to prepare consolidated financial statements. Consider a private company (company B) that is itself the wholly owned subsidiary of another private company (company A) and which has a wholly owned subsidiary of its own (company C). Neither company A nor company B would satisfy the requirements to be exempt from preparing consolidated financial statements in South Africa. Company A because it is the ultimate holding company, and company B because company A's consolidated financial statements are not available for public use under South African law. However, should the proposal of the Institute of Directors in South Africa (2002) that certain categories of private companies be required to file their financial statements with the Registrar of Companies be promulgated, then company A's consolidated financial statements may under South African law become available for public inspection, in which case company B may not need to prepare consolidated financial statements.

2.7 Summary

A form of differential corporate reporting is in existence in South Africa as the financial reporting requirements of South African securities exchange listed companies, unlisted companies and close corporations are all different. Further, SA GAAP contains differential reporting requirements in the form of exemptions and scope restrictions that give effect to additional differential corporate reporting thresholds.

South African corporate reporting requirements, while being less onerous for close corporations, effectively require all companies, irrespective of their size and to whom their financial statements are available, to prepare their financial statements in accordance with SA GAAP. SA GAAP is designed to produce general purpose financial statements that meet the needs of a wide range of users, many of which are not in a position to demand additional information from the reporting entity. These reporting requirements are not necessarily appropriate to all companies. South African proposals to address this perceived inequity are examined in chapter 3. These proposals are likely to result in fundamental changes to South African corporate law.

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Chapter 3

CORPORATE REPORTING PROPOSALS

3.1 Introduction

In chapter 2, it was established that a very limited form of differential corporate reporting already exists in South Africa. This conclusion was reached as the financial reporting requirements of South African listed companies, unlisted companies and close corporations are all different. However, the *status quo* is widely regarded as being untenable, for example DTI (2004:16), Institute of Directors in South Africa (2002:126) and SAICA (2002c:5), particularly with respect to certain private companies. The South African Institute of Chartered Accountants (SAICA) in conjunction with the legislature developed proposals that were the subject of a consultative forum hosted by the SAICA (SAICA,2002c, 2002d, 2002e). These proposals have been subject to four revisions (SAICA,2002a). Draft 4 of these proposals is examined in this chapter in the context of the comprehensive corporate law review being undertaken by the South African Department of Trade and Industry (DTI) (DTI,2004). Further, as South African statements of generally accepted accounting practice (SA GAAP) are cloned from the international financial reporting standards (IFRS) of the International Accounting Standards Board (IASB), the IASB's preliminary views on differential reporting are also examined in this chapter. The IASB's differential reporting project is likely to have implications for South African differential corporate reporting and has been issued for public comment in South Africa by the SAICA.

The examination of current South African differential reporting proposals is presented in this chapter. The research and international practices from which they were derived and their development in global differential reporting practices are discussed in chapter 4.

3.2 Background

In the twentieth century, much of the debate around differential corporate reporting centred on the small-large entity distinction (SAICA,2001b). It was commonly argued that it was unreasonable to expect smaller entities to comply with financial reporting standards developed for the financial reporting requirements of large multinational corporations (SAICA,2002d:4).

By the twenty-first century, the focus of the differential reporting debate had shifted from the quantitative characteristics of entity size to qualitative characteristics, for example CICA (2002a:para3), Mersereau (2002:31), Pacter (2004:118) and SAICA (2001b:6). The shift to qualitative characteristics, primarily public accountability, resulted in the purpose of financial statements being revisited, for example CICA (2002a), IASCF (2004), ICANZ(2002) and SAICA (2002a). In some jurisdictions, this resulted in two tiers of reporting requirements. Firstly, entities with public accountability are required to prepare financial statements in accordance with general purpose financial reporting standards, that is, national GAAP or IFRS. Secondly, entities that do not have public accountability are permitted to prepare financial statements in accordance with less onerous financial reporting requirements. The less onerous reporting requirements frequently take the form of limited formalised deviations from national GAAP (CICA,2002a; ICANZ,2002) and are sometimes referred to as limited purpose financial reporting standards (LPFRS).

Meaningful differential reporting options are not yet available to South African entities. This chapter examines recent South African differential reporting proposals that are widely expected to result in meaningful differential reporting options being implemented in South Africa in the foreseeable future.

3.3 The draft proposed financial reporting bill

The SAICA in conjunction with the South African Government developed differential reporting proposals that were the subject of a consultative forum hosted by the SAICA (SAICA,2002c, 2002d, 2002e). These proposals have been subject to four revisions (SAICA,2002a). The proposed financial reporting bill (draft bill) established a threshold for differential reporting based on the reporting entity's form and its financial statement user base (5). Although the draft bill proposed that entities qualifying for differential reporting options be required to prepare financial statements in accordance with LPFRS, it delegated the responsibility for developing LPFRS to local standard-setters. The next subsection analyses the SAICA's proposed LPFRS.

Draft 4 of the draft bill proposes that South African entities prepare their financial statements in compliance with general purpose financial reporting standards where (SAICA,2002a:5):

"(a) any users of the financial statements of the entity have to rely solely on those financial statements for financial information regarding the entity; or
(b) the entity receives deposits or loans from members of the general public or where the securities of the entity are issued to members of the general public."

The draft bill also proposed that South African entities prepare their financial statements in accordance with LPFRS where (SAICA,2002a:5):

"(a) There are no users of those financial statements of a class contemplated in paragraph (a) of the definition of 'general purpose financial reporting standards'; or
(b) All of the users of those financial statements as contemplated in paragraph (a) of the definition of 'general purpose financial reporting standards' have waived, in accordance with a relevant act, their right to receive financial statements complying with general purpose financial reporting standards and have consented to the issuing to them of financial statements complying with limited purpose financial reporting standards."

Further, the draft bill proposed that the Companies Act be amended so as to permit a private company, with the unanimous consent of all its members, to prepare its annual financial statements in accordance with LPFRS provided that it does not receive deposits or loans from members of the general public and its shares are not issued to members of the general public (SAICA,2002a:33).

In anticipation of the promulgation of the draft bill, SAICA (2003a) developed LPFRS. However, in May 2004 the DTI commenced a comprehensive corporate law review that is expected to supersede the draft bill.

3.4 Exposure draft 163 – Differential corporate reporting

In June 2003, after the questionnaires upon which this study is based were received back from the respondents, the SAICA exposed for public comment its proposed LPFRS for use by entities that qualify in terms of the draft bill to prepare financial statements in compliance with LPFRS, namely, ED 163 (SAICA,2003a:para3). The proposals included exempting qualifying entities from some of the requirements of IFRS. SAICA deliberately referred to IFRS, as SA GAAP is being harmonised with IFRS.

The SAICA justified the exemptions proposed in ED 163 on the basis of:

- Users and their information needs (para7). The users of LPFRS are the owners, South African Revenue Services, lenders and anyone else entitled to receive the financial statements in terms of any Act (para9). Such users are not solely dependent of the financial statements of the enterprise for decision-making purposes.

- A different assessment of the requirement for comparability (para7). The users of LPFRS are less concerned with comparability between the financial statements of different users (para12).
- A different assessment of balance between benefit and cost (para7). Benefits usually decrease with a decrease in the number and diversity of users and their information needs (para13).

The proposal included the relaxation of certain disclosure requirements of IFRS and very limited relaxation of certain recognition and measurement requirements of IFRS, that is, in respect of deferred taxation (para28) and aspects of financial instruments (para38). These alternatives were justified on the grounds that the costs to the reporting entity of compliance with IFRS would exceed the benefits arising from compliance enjoyed by the users (para22).

SAICA (2003a) further proposes that qualifying entities be exempted from the requirements to present:

- a cash flow statement (para27), and
- consolidated financial statements (para34).

The exemptions proposed from the requirements of IFRS for entities that qualify to prepare financial statements in accordance with the LPFRS are summarised as follows:

- IAS 1 (AC 101) - Presentation of financial statements: Exempt from the requirement to prepare a cash flow statement.
- IAS 2 (AC 108) - Inventories: Exempt from certain detailed disclosure requirements where inventories are impaired or a prior period impairment of inventory is reversed.
- IAS 7 (AC 118) - Cash flow statements: Exempt from the requirement to prepare a cash flow statement.
- IAS 12 (AC 102) - Income taxes: Exempt from the requirement to provide for deferred tax.
- IAS 14 (AC 115) - Segment reporting: Exempt from the requirements to report financial information by segment.
- IAS 16 (AC 123) - Property, plant and equipment: Exempt from the requirement to disclose the depreciated historic cost of revalued classes of property, plant and equipment.
- IAS 17 (AC 105) - Leases:
    - Exempt the lessee in a finance lease from all of the IAS 17 (AC 105) disclosure requirements that require for each class of asset, the net carrying amount at balance

sheet date to be disclosed.

- Exempt the lessee in an operating lease from the requirement to disclose lease and sublease payments recognised in income and from the requirement to present a general description of its significant leasing arrangements.
- Exempt the lessor in a finance lease from all of the IAS 17 (AC 105) disclosure requirements.
- Exempt the lessor in an operating lease from the requirement to disclose total contingent rents recognised in income and from the requirement to present a general description of its significant leasing arrangements.

The above listed exemptions for both lessees and lessors do not provide for exemption from the disclosure requirements of IAS 39 (AC 133).

- IAS 21 (AC 112) - The effects of changes in foreign exchange rates: Exempt from the requirement to present:
  - a reconciliation of exchange differences classified as a separate component of equity at the beginning and the end of the period; and
  - disclosures in respect of a change in the classification of a significant foreign operation.
- IAS 27 (AC 132) - Consolidated financial statements: Exempt from the requirement to present consolidated financial statements.
- IAS 28 (AC 110) - Accounting for investments in associates: Exempt from the requirements of IAS 28 (AC 110) to the extent that consolidated financial statements are not required to be presented.
- IAS 31 (AC 119) - Financial reporting of interests in joint ventures: Exempt from the requirements of IAS 31 (AC 119) to the extent that consolidated financial statements are not required to be presented.
- IAS 32 (AC 125) - Financial instruments: disclosure and presentation: Exempt from the requirement to split compound financial instruments, that is, ED 163 introduces an allowed alternative of classifying the compound financial instrument according to its main element.

  ED 163 also provides for exemption from the requirement to present financial risk management objectives and policies and credit risk disclosures.
- IAS 39 (AC 133) - Financial instruments: recognition and measurement: Where in accordance with the allowed alternative set out in respect of compound financial instruments above, ED 163 introduces an allowed alternative of recognising and measuring the compound financial instrument according to its main element. ED 163 also provides for exemption from the requirement to present:
  - the methods and significant assumptions applied in estimating fair values of assets and

liabilities that are carried at fair value;

- a description of the entity's financial risk management objectives and policies; and
- the IAS 39 (AC 133) paragraph 171(b) disclosures where the presumption that fair value can be measured reliably for all financial assets that are available for sale or held for trading has been overcome.

- IAS 33 (AC 104) - Earnings per share: Exempt from the requirement to present earnings per share.
- IAS 34 (AC 127) - Interim financial reporting: Exempt from the requirement to present interim financial statements.
- IAS 36 (AC 128) - Impairment of assets: In respect of an impairment loss that is recognised or reversed during the period and that is material to the financial statements of the reporting enterprise as a whole, exemption from:
  - the segment specific disclosure requirements; and
  - the requirement to describe the current and former way of aggregating assets and the reason for the change where the aggregation of assets identifying the cash-generating unit has changed since the previous estimate of its recoverable amount.
- IAS 37 (AC 130) - Provisions, contingent liabilities and contingent assets: Exempt from the requirement to disclose in respect of each class of provision:
  - a brief description of the nature of the obligation and expected timing of the cash outflows;
  - an indication of the uncertainties and the major assumptions; and
  - the amount of any expected reimbursement.

Where qualifying entities have prepared their financial statements in accordance with the LPFRS, they must in the accounting policies notes disclose the fact that LPFRS have been adopted and full details of the allowed alternatives adopted.

The relief proposed in ED 163 is inadequate and unlikely to bring much relief to qualifying companies as:

- private companies are not required to comply with some of the more significant time saving exemptions proposed by ED 163, such as, the presentation of segmental disclosures, earnings per share and the presentation of interim financial statements, and
- the proposed recognition and measurement concessions were particularly limited.

In June 2004, the IASB issued a discussion paper setting out its preliminary views on accounting standards for small and medium-sized entities (DP SME) (IASCF,2004). DP SME was immediately issued for comment in South Africa by SAICA as ED 181 and supersedes ED 163. The DTI's 2004 comprehensive guidelines for corporate law reform are reviewed in the next subsection after which the proposals of ED 181 are discussed.

3.5 Corporate law reform

3.5.1 Objectives

In May 2004, the DTI commenced a comprehensive corporate law review. The objectives of the review that have implications for differential corporate reporting include:

- The regulatory scheme should not create artificial preferences and distortions (9). To give effect to this objective, the DTI proposes having only one form of corporate entity, thus proposing the abolition of close corporations and the private-public company distinction (29).
- The regulatory policy needs to recognise the unique South African context (9). Recent socio-political and economic changes in South Africa underscore the need for social responsiveness, transparency and accountability of companies (14). The principles enshrined in the South African Constitution are reflected in recent South African Acts that have financial reporting implications, such as, the Employment Equity Act (15). Further, proposed black economic empowerment disclosures will add reporting requirements unique to South Africa.
- The efficiency of companies and their management and reducing the costs associated with the formalities of forming a company and maintaining its existence should be promoted (10). This objective is underpinned by the perception that much of the information currently required to be reported, in accordance with the requirements of the Companies Act, is of questionable use to the commercial and investment community (16). For example, it is proposed that the artificial distinction between share capital and share premium be abolished (17).
- Transparency and high standards of corporate governance, recognising the broader social role of companies should be encouraged (10). To give effect to this objective, the government has resolved to make improvements to accounting standards and the regulatory framework for accountants including legal backing for accounting standards (12). As a result of South Africa's peculiar social and political history these matters should not only follow

world trends, such as, triple bottom line reporting, but should take account of the country's particular circumstances, notably the Constitution and various regulations for the benefit of other groups (26). In effect, a company's pursuit of economic objectives should be constrained by social and environmental imperatives (27) thus placing a greater emphasis on corporate citizenship (28).

- Comparability and harmonisation with best practice jurisdictions internationally should be ensured (10). Responsiveness to increased globalisation underpins this objective (14).

3.5.2 Desirability

The DTI envisages that a single South African formal business vehicle, that is the company, will be recognised in the future (32). However, multiple tiers of companies will be distinguished which will determine their reporting requirements (SAICA,2004c). The DTI's intention to implement differential corporate reporting requirements is perhaps most clearly evident in their proposal to exempt smaller companies from the requirement to prepare financial statements, subject to the consent of 90% of the reporting entities shareholders (DTI,2004:38). This exemption is justified on the basis of reducing the cost and compliance burden on smaller companies.

The corporate law reform process clearly demonstrates that the South African government considers differential corporate reporting desirable in the South African context.

3.5.3 Threshold

The DTI (2004:30) proposes increased emphasis on the access to and disclosure of information relevant to stakeholders, particularly shareholders. Significant emphasis is also proposed for the information needs of other stakeholders some of which are unique to South Africa (26-27). Meeting the information needs of stakeholders which have traditionally been overlooked, suggests that financial reporting requirements are generally likely to become more onerous. However, the DTI envisages that through the promulgation of differential corporate reporting options, the reporting burden may be significantly less onerous for smaller companies (38).

The DTI recognises the importance of differential requirements for companies that have different characteristics (32). They identify the listed-unlisted distinction as perhaps being the most important differentiating factor. Support for this basis of differentiation is found in the USA where non-public companies are not required to prepare their financial statements in accordance with US GAAP (Edwards,2004:40).

As some large companies may have a small number of shareholders, the DTI does not perceive the number of shareholders to be an appropriate basis of differentiation (DTI,2004:32). The reference to large companies indicates that the DTI views company size as an important basis of differentiation. This assertion is further supported by the DTI's reference to the need to reduce the costs and compliance burden of smaller companies (38). Further, the DTI indicates that turnover may be an appropriate basis for differentiation between bigger and smaller unlisted companies (33). In the author's opinion, it is unlikely that differential reporting thresholds determined on the amount of turnover alone could meaningfully differentiate smaller companies from larger companies. Perhaps for this reason, the existing size based differential reporting threshold determinants of several countries, such as, Australia, New Zealand and the UK apply a combination of three quantitative measures, namely, amount of turnover, value of assets, and number of employees, in setting differential reporting thresholds (AARF,1990; ICANZ,2002; ICAEW,2001). The differential reporting threshold determinants of key standard-setting nations are analysed in chapter 4.

3.5.4 The way forward

The DTI has not finalised its views on the thresholds, form and content for differential corporate reporting in South Africa. SAICA have been requested to research how companies should be divided into tiers and what the reporting requirements of each tier should be (SAICA,2004c). Drafting of the new corporate legislation and related exposure draft is scheduled for completion by August 2005 (DTI,2004:53). The proclamation of the resultant Bill by the President is scheduled for June 2006.

In the global economy where financial reporting requirements are increasingly being harmonised with those of the IASB, their differential reporting project, which is analysed in the next subsection, will undoubtedly impact upon the differential reporting options that will arise from the South African corporate law reforms. A possible outcome could be that the South African government promulgates legislation that requires or allows one or more tier/s of South African companies to prepare their financial statements in accordance with IASB SME Standards.

3.6 The IASB's differential reporting project

During 2003, after the questionnaires upon which this study is based were received back from the respondents, the IASB began developing accounting standards appropriate for small and

medium-sized entities (IASB SME Standards) (IASB,2003). In June 2004, the IASB issued DP SME which invited public comment on the preliminary views of the IASB regarding the development of IASB SME Standards (IASCF,2004). The issues identified by the IASB and the IASB's preliminary views on those issues are summarised in table 3-1.

Table 3-1 Issues and preliminary views of the IASB

Issue	Preliminary view
Should the IASB develop financial reporting standards for SMEs?	IFRS are suitable to all entities
	The IASB will develop IASB SME Standards
	Entities that follow IASB SME shall disclose that fact
Objectives of IASB SME Standards	Provide high quality, understandable and enforceable accounting standards suitable for SMEs globally
	Focus on meeting the needs of users of SME financial statements
	Be built on the same conceptual framework as IFRS
	Reduce the financial reporting burden on SMEs that want to use global standards
	Allow easy transition to IFRS for those SMEs that become publicly accountable or choose to switch to IFRS
Threshold for applying IASB SME Standards	No size test
	IFRS apply to an entity that has public accountability or that has prepared financial information in accordance with IFRS
Resolution of issues not addressed in IASB SME Standards	Mandatory fallback to IFRS
Where an IASB SME Standard is more restrictive than IFRS	Optional reversion to an IFRS on a standard-by-standard basis
Approach to the development of IASB SME Standards	Developed from IFRS, including the framework, standards and interpretations
Basis of modification of IFRS in developing IASB SME Standards	Modifications can only be justified on the basis of: • identified needs of users, or • cost-benefit analysis
	Likely that presentation and disclosure modifications will be justified
	Rebuttable presumption that no recognition and measurement modifications will be made
Form of IASB SME Standards	A separate volume organised by IFRS numbers

3.6.1 Desirability

The International Accounting Standards Committee (IASC) the predecessor to the IASB, recognised that a demand exists for a special version of IFRS for small enterprises (IASCF,2004:paraIN5). The Trustees of the IASC Foundation, the body that governs the IASB, also support efforts by the IASB to examine issues particular to emerging economies and to small and medium-sized entities. The IASB is of the preliminary view that IFRS are suitable for all entities (para4). However, it will develop IASB SME Standards. This preliminary view is grounded in the perception that the information needs of the users of financial statements of entities that have public accountability are different to those that do not have public accountability and the application of the cost-benefit considerations (para7).

3.6.2 Form

It is the preliminary view of the IASB that IASB SME Standards should take the form of a separate volume derived from the existing IFRS (para88). This is consistent with the following other preliminary views of the IASB:

- IFRS are the starting point for the development of IASB SME Standards (para62);
- There should be a mandatory fallback to IFRS where IASB SME Standards do not address a particular recognition or measurement issue (para46); and
- IASB SME Standards should be based on the same conceptual framework as IFRS (para16(c)).

3.6.3 Threshold

The IASB's preliminary view regarding the threshold for the use of IASB SME Standards is that national jurisdictions should determine which, if any, entities should be permitted to follow IASB SME Standards. However, in describing the characteristics of SME's for which the IASB intends the IASB SME Standards to apply, the IASB expressly excludes quantitative, that is, size tests (para26) and instead applies the principle of no public accountability as the overriding characteristic for the application of IASB SME Standards (para35). In accordance with paragraph 28:

"[a]n entity has public accountability if:

(a) there is a high degree of outside interest in the entity from non-management investors or other stakeholders, and those stakeholders depend primarily on external financial reporting as their means of obtaining financial information about the entity; or
(b) the entity has an essential public service responsibility because of the nature of its operations."

Presumptive indicators that an entity has public accountability include:

- The filing of its financial statements with a regulatory authority for the purposes of issuing any class of instruments in a public market (para31). However, an entity does not become publicly accountable simply because it is required to submit its financial statements to a central registry maintained by a government agency as a result of which it is open to public inspection (para30).
- It holds assets in a fiduciary capacity for a broad group of outsiders (para31).
- It provides an essential public service.
- It is economically significant in its home country. Arguably, this is a quantitative criterion.

Further, an entity that otherwise would be regarded as having no public accountability, would be regarded as having public accountability if, after informing all of its owners that it intends to prepare IASB SME Standards compliant financial statements, any owner objected thereto (para33).

Finally, it is the IASBs' preliminary view that IASB SME Standards are not intended as a means of avoiding the reporting of information that has already been produced for other purposes (para39). Consequently, where an entity prepares financial information in accordance with IFRS to meet the requirements of one or more of its publicly accountable investors, then it should prepare its financial statements in accordance with IFRS (para38).

3.6.4 Content

In designing IASB SME Standards, the IASB envisages deviations from IFRS based only on user needs and cost/benefit analysis (para66). The IASB's preliminary view is that IASB SME Standards will only contain a relatively limited number of modifications to IFRS (para76). While presentation and disclosure modifications are expected (para67), there is a rebuttable presumption that no modifications are to be made to the recognition and measurement principles in IFRS (para68). The rebuttable presumption may more easily be overcome for measurement principles than for recognition principles (para82).

Where IASB SME Standards do not address a particular issue, it would be mandatory to address that issue in accordance with IFRS (para46).

Where an entity prepares its financial statements in accordance with IASB SME Standards, it shall make disclosure of that fact in the basis of presentation note. The auditor's report shall also clearly state the basis upon which the audited financial statements were prepared, that is, in accordance with IASB SME Standards (para4).

3.7 Evaluation of the current proposals

The relief proposed in ED 163 is considered to be disappointing and of little value (Everingham & Watson,2003:9). However, if enacted, qualifying entities may enjoy some relief notably from the concessions to elect not to: (i) present a cash flow statement; (ii) prepare consolidated financial statements; (iii) provide for deferred tax; and (iv) split compound financial instruments into their equity and liability components.

The IASB's DP SME (IASCF,2004) is the first step in the development of global reporting standards for SMEs. Given the disparity in users of SME financial statements within any given jurisdiction, and the substantial disparities in accounting knowledge between the SME sectors and the users of their financial statements of different jurisdictions globally, the author finds it difficult to envisage how a single set of IASB SME Standards, albeit designed with some flexibility, that is, the proposed standard-by-standard election, derived from IFRS developed to meet the needs of broadly based users of securities exchange listed entities, could possibly be suitable for SMEs globally. This incongruence is illustrated by the IASB whose response to the suggestion that IASB SME Standards should have as their objective to provide management of an SME with the management information needed to carry out its planning, decision-making and control responsibilities, is that the "IASB's objectives are to develop standards for the information in general purpose financial statements ... To help investors, creditors and others who provide resources to the entity make economic decisions ..... Standards for management information are not an objective of the IASB generally or with respect to SMEs" (IASCF,2004:para18). In the author's view, this is problematic where management are the primary users, as conceivably frequently will be the case, and especially where management are the only users of the financial statements, as conceivably may be the case in limited circumstances. A similar incongruence exists where the tax authorities are the primary or only user of a SME's financial statements as the proposed IASB SME Standards are not intended to meet the needs of the tax authorities (IASCF,2004:para19). However, relief in such situations may be found in the ultimate decision as to which entities use IASB SME Standards resting

with national regulatory authorities and standard-setters (IASCF,2004:20). Meeting the needs of the sole users of a SME's financial statements may require a fundamentally different basis of preparation, for example, the tax basis where the tax authorities are the only users. The IASB does not appear to envisage this degree of flexibility as it clearly would not be consistent with the definitions and recognition criteria of elements financial statements contained in its conceptual framework.

In conclusion, the author is of the opinion that it is fitting that the IASB develop IASB SME Standards in accordance with its preliminary views. Such IASB SME Standards would alleviate the reporting burden of many SME's and would better fulfil the information needs of many users of SME's financial statements on a globally comparable basis. However, the one-size-fits-all approach is likely to be of little benefit to those SME's that:

- are very small, because the cost-benefit analysis applied in developing IASB SME Standards is not intended to be applied with reference to the individual entity; and
- have limited focussed users. For example, where management are the only users, it is inefficient to prepare financial statements under any basis other than that which best serves their management needs.

It is therefore incumbent upon national standards setters and regulatory authorities to carefully take cognisance of their domestic socio-economic and other conditions when deciding which entities, if any, should be required or be permitted to prepare financial statements in accordance with IASB SME Standards. The DTI's corporate law review appears to offer a suitable resolution to this dilemma by implementing multiple financial reporting tiers for South African companies. This could, for example, result in: i) securities exchange listed companies being required to prepare their financial statements in accordance with IFRS; ii) larger unlisted companies being allowed to prepare their financial statements in accordance with IASB SME Standards; and iii) smaller unlisted companies being allowed to prepare their financial statements in accordance with some other comprehensive basis of accounting.

3.8 Summary

This chapter summarised and analysed recent corporate reporting proposals that are expected to impact on differential reporting in South Africa.

First, the draft bill was analysed. This analysis established the initial co-operative efforts of SAICA and the South African government to implement differential reporting requirements in

South Africa. The draft bill proposed that differential reporting take the form of LPFRS for a private company that does not have public accountability, provided that it first obtained the unanimous consent of its members. To facilitate the passing of the draft bill, SAICA developed LPFRS and exposed them for public comment in the form of ED 163.

Next the proposals of ED 163 were summarised and assessed. The relief proposed in ED 163 was limited primarily to selected presentation and disclosure requirements of SA GAAP. However, the proposal that qualifying private companies may elect not to i) present a cash flow statement, ii) prepare consolidated financial statements, iii) provide for deferred tax, and iv) split compound financial instruments was likely to provide some relief. Notwithstanding, it was concluded that the relief proposed in ED 163 was inadequate. In June 2004, the IASB issued DP SME. In South Africa, DP SME superseded ED 163 when the SAICA issued it as ED 181 for public comment.

The preliminary views of the IASB contained in DP SME (ED 181) were then summarised and assessed. Based on the assessment made, it was concluded that IASB SME Standards developed in accordance with DP SME may alleviate the reporting burden of many SMEs that do not have public accountability. Further, DP SME Standards would better fulfil the information needs of the users of many SME's financial statements and would have the advantage of being comparable globally. However, the one-size-fits-all approach adopted by the IASB will be of little benefit to those SMEs that have limited focussed users. The IASB envisages that national legislators and standard-setters, as the case may be, could provide relief to such SMEs by determining which entities are required or permitted to prepare their financial statements in accordance with IASB SME Standards.

Concurrent to the IASB's differential reporting project, the DTI is undertaking a comprehensive South African corporate law reform project. The DTI's differential corporate reporting proposals contained in their corporate law reform document provides for multiple tiers of South African companies each with their own reporting requirements. This could, for example, result in: i) securities exchange listed companies being required to prepare their financial statements in accordance with IFRS; ii) larger unlisted companies being allowed to prepare their financial statements in accordance with IASB SME Standards; and iii) smaller unlisted companies being allowed to prepare their financial statements in accordance with some other comprehensive basis of accounting.

The corporate reporting proposals evaluated in this chapter, together with the existing corporate reporting requirements analysed in chapter 2 and the background information established in

chapter 1, provide a solid frame of reference for the literature review that is presented in the next chapter.

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Chapter 4

LITERATURE REVIEW

4.1 Introduction

Chapter 2 focussed on the current legal framework within which corporate reporting is undertaken in South Africa. Chapter 3 focussed on the current proposals for differential corporate reporting in South Africa. This chapter traces the development of differential corporate practices globally. The key elements of the current differential reporting practices of influential standard-setting bodies are summarised to provide the context in which the literature review that forms the main part of this chapter was undertaken. The result of the archival research in this and the preceding chapters provides the input from which the postal questionnaire research phase, reported on in the chapters that follow, was developed. The literature review conducted in this chapter further provides a basis for comparison of the research findings of the postal questionnaire conducted in this study.

This dissertation is concerned with differential corporate reporting in the South African context. As South Africa's unique socio-economic context (DTI,2004:9) may necessitate unique differential corporate reporting requirements, this dissertation will review only a selection of the most comprehensive international differential corporate reporting studies. However, all known South African studies, irrespective of their comprehensiveness and stage of completion, are discussed in this chapter.

4.2 Background

In the information era, reporting requirements in respect of general purpose financial statements are necessarily complex and increasingly voluminous (Lavigne,1999:50). Such financial statements are designed to satisfy the information needs of multiple divergent broadly based user groups, many of which are not in a position to demand additional information from the entity. South African statements of generally accepted accounting practice (SA GAAP) like the international financial reporting standards (IFRS) on which they are based, are designed to meet the needs of these users (SAICA,1990:2). While less onerous financial reporting requirements exist for South African close corporations, South African corporate reporting requirements effectively require all companies, irrespective of their form, size and to whom their financial statements are available, to prepare financial statements in accordance with SA GAAP. It is

widely acknowledged both in South Africa (Hattingh,1999:21, 2001:23, 2002a:29, 2002b:24; Institute of Directors in South Africa,2002:126; Koppeshaar,2002:2) and internationally (Baskerville & Simpkins,1997:14; Hepp & McRae,1982:52; Holmes, Kent & Downey,1991:125; Mersereau,2002:30) that such reporting requirements are not necessarily appropriate to all companies and compliance therewith can result in substantial costs being incurred without sufficient, if any, benefit. However, having two sets of rules may bring accounting into disrepute and force users to incur extra costs (Walton,1998:2). It may also involve arbitrary cut-off and impair comparability (Carsberg, Page, Sindall & Waring, 1985:16).

Hattingh (2001:23) identifies the benefits of SA GAAP to listed companies as a reduction in its cost of capital and cost savings if a cross-border listing is obtained. It is widely acknowledged that SA GAAP frequently results in private companies incurring compliance costs that render little benefit to financial statement users (Hattingh,2001:23; SAICA,2001b:1, 2003a:3). Private company financial statements are not public documents and therefore are frequently only made available to the shareholders, managers, South African Revenue Services and financial institutions (SAICA,2003a:3). These users generally have the right to demand additional information from the company and therefore are not solely reliant on the company's financial statements as their sole source of information. Financial institutions could as a condition of a loan, require private companies to prepare SA GAAP compliant financial statements if they deemed this to be necessary. Current corporate reporting requirements for many South African private companies thus violate the accounting framework's own cost-benefit constraint. Paragraph.44 of the framework (SAICA,1990:13) describes the cost benefit constraint as follows "The benefits derived from information should exceed the cost of providing it."

Walton (1998:2) presents the international views of those opposed to differential reporting as follows: "...having two sets of rules brings accounting into disrepute and forces users to incur extra costs". Also presenting the views of those opposed to differential reporting Edwards (2004:40) sites the lack of conceptual theory underlying differential reporting. In presenting key arguments in favour of the universal application of accounting standards Carsberg *et al* (1985:16) add that distinction according to size is bound to involve arbitrary cut-off that would be hard to defend, and that standards are intended to promote comparability and therefore universal application is needed if large companies' accounts are to be comparable with those of smaller companies.

Research into the information needs of American loan officers led some researchers, for example, Calderon (1990:116) and Stanga and Tiller (1983:69), to conclude that the information

needs of loan officers do not differ substantially for small private companies and large public companies.

The inappropriateness of entity size as a determinant for differential reporting thresholds is increasingly acknowledged by standard-setters (IASB,2003). In rebutting the balance of the arguments against differential corporate reporting, Edwards (2004:40) cites the cost benefit constraint and the fact that private company inter-company comparisons are less frequent than public companies.

4.3 International practices

Differential corporate reporting is in its infancy and there remain many inconsistencies in the differential reporting requirements of the countries examined. These differences relate not only to the determination of which entities qualify for differential reporting, that is, threshold determinants, but also in respect of the basic form of the differential reporting options and the detailed contents of qualifying entities' financial statements. These matters are discussed in the subsections following the brief historical overview of the implementation of differential reporting requirements by leading western standards-setting nations.

4.3.1 Historical overview

4.3.1.1 United States of America

With effect from April 1978, the United States of America's (USA) standard-setter the Financial Accounting Standards Board (FASB) no longer required non-public enterprises to report earnings per share and segment information (Stanga & Tiller,1983:63). This represents the earliest efforts of a standard-setter known to the author to implement a form of differential corporate reporting. In the USA, it was subsequently legislated that only public companies are required to prepare financial statements in accordance with US GAAP (Mersereau,2002:30). Non-public USA enterprises, for example, private companies, are permitted to prepare their financial statements in accordance with an other comprehensive basis of accounting (OCBOA) commonly, the tax basis or modified cash basis of accounting (Edwards,2004:40). The effect of this legislation has resulted in entity form, that is, the listed-unlisted divide, being the threshold for differential reporting in the USA.

Currently in the USA, the American Institute of Certified Public Accountants' (AICPA) Private Company Financial Reporting Task Force is studying the issue of financial reporting for privately held businesses. Further, although not directly a differential reporting initiative, the FASB has established a small business advisory committee to obtain more active involvement from the small business community in the development of accounting standards in the USA (Edwards,2004:40).

4.3.1.2 Australia

In 1990, differential reporting came into effect in Australia when the Australian Accounting Research Foundation (AARF) introduced the concept of the reporting entity in its statement of accounting concepts SAC 1 (AARF,1990:para2). The concept of the reporting entity is tied to the information needs of users (para12) and is not dependent on: (i) the sector, public or private, within which the entity operates; (ii) the purpose for which the entity was created; or (iii) the manner in which the entity is constituted (para13). When it is reasonable to expect that no users are dependent upon information contained in general purpose financial reports for economic decision-making about an entity, it need not prepare general purpose financial statements, that is, Australian GAAP compliant financial statements (para36). However, other parties may require the entity to prepare Australian GAAP compliant financial statements (para33). For example, Section 45A of the Australian Companies Act requires bigger Australian companies (refer to table 4-1) to prepare Australian GAAP compliant financial statements (SAICA,2001b:2). Australian non-reporting entities may choose to prepare their financial statements in accordance with another appropriate disclosed comprehensive basis of accounting.

The overriding characteristic of an Australian reporting entity is that its users are dependent on general purpose financial reports for information for making and evaluating resource allocation decisions (AARF,1990:para12).. For entities in respect of which it is not readily apparent that users are dependent on their general purpose financial reports for information for making and evaluating resource allocation decisions, SAC 1 provides the following inconclusive factors that, amongst others, are applied in judging whether an entity is a reporting entity (para19):

- Ownership/membership of the entity is widely spread (para20).
- Management of the entity is separate from its owners/members (para20).
- The entity is economically or politically important, for example, entities that dominate a market (para21).
- The entity is large (para22).

- The entity has large liabilities (para22).

4.3.1.3 New Zealand

In 1994, differential reporting was implemented in New Zealand when the Institute of Chartered Accountants of New Zealand (ICANZ) issued its framework for differential reporting (Baskerville & Simpkins,1997:14). The differential reporting framework was revised in 1997 and 2002 (ICANZ,2002). The 1997 revision primarily increased the quantitative threshold for differential reporting (Baskersville *et al*,1997:15) and the 2002 revision extended the differential reporting options available to qualifying entities (ICANZ,2002). Like their Australian counterparts, the ICANZ justify their differential reporting options on cost-benefit considerations underpinned by user needs (para3.2-3.3). However, differential reporting options in New Zealand take the form of full exemption from selected New Zealand financial reporting standards and partial exemption from others (Baskerville *et al*,1997:17).

The differential reporting framework makes provision for differential reporting in respect of New Zealand entities that do not have public accountability and (para4.25):

- all of its owners are members of its governing body; or
- it is not large in size (refer to table 4-1).

A further differential corporate reporting threshold exists in New Zealand as an exempt company need only present its financial statements in accordance with the less onerous matters prescribed by the Governor-General by Order of Council (ICANZ,2002:para4.7). An exempt company is defined in Section 2 of the Financial Reporting Act as, amongst other requirements, having a turnover not exceeding $1 000 000 and the value of its total assets not exceeding $450 000. This additional differential reporting threshold has the effect of imposing minimal corporate reporting requirements on very small New Zealand companies.

4.3.1.4 The United Kingdom

In 1997, differential reporting became effective in the United Kingdom (UK) when the Accounting Standards Board issued its financial reporting standard for smaller enterprises (FRSSE) (Mersereau,2002:30). Under FRSSE, qualifying entities were initially exempted from the requirement to prepare a cash flow statement and were subject to relaxed presentation and disclosure requirements (Walton,1998:3). Through a number of revisions FRSSE later included

limited measurement simplifications (ICAEW,2001). The threshold for the application of FRSSE is primarily quantitative tests, as set out in table 4-1. However, certain entities that have public accountability are barred from applying FRSSE. FRSSE takes the form of a standalone document that is applicable to qualifying companies' financial reporting in Great Britain, Northern Ireland and the Republic of Ireland.

4.3.1.5 Canada

In January 2002, progressive differential corporate reporting options became effective for non-publicly-accountable Canadian private companies when the Canadian Accounting Standards Board (AcSB) introduced Section 1300 - Differential reporting into the Canadian Institute of Chartered Accountants' (CICA) Handbook (CICA;2002a:i). To qualify for differential reporting options, an entity must have no public accountability (Mersereau,2002:30). Six differential reporting options were initially made available to qualifying entities (32). Further, the AcSB undertook to examine all differential reporting issues as new accounting standards are developed. To give effect to this, the AcSB established the Small Business Enterprises Advisory Committee that was subsequently renamed the Differential Reporting Advisory Committee (DRAC) (31). DRAC recommends differential corporate reporting options to the AcSB using a cost-benefit decision model (Edwards,2004:39). Application of the model requires assessment of:

- the benefits to non-manager owners and creditors of a proposed differential reporting option in relation to the fundamental qualitative characteristics of understandability, relevance and reliability; and
- the preparation costs, communication costs, specialised expert costs and related audit or review costs.

As a result of DRAC's efforts, two additional differential reporting options are in the process of being finalised (38).

4.3.2 Threshold

Determining which entities should qualify to prepare financial statements in accordance with lesser reporting requirements, such as limited purpose financial reporting standards, has been a matter of much debate, for example, AARF (1990), IASCF (2004), Mersereau (2002) and SAICA (2001b). Much of the criticism has focussed on the inappropriateness of applying

quantitative criteria in determining the threshold and resulted in a trend toward qualitative threshold decision criteria, for example, AARF (1990:para36), IASCF (2004:para26), Mersereau (2002:31) and SAICA (2001b:6).

There has been little consensus in the world in identifying which entities should qualify for differential corporate reporting options. In setting differential reporting thresholds, some financial reporting jurisdictions, such as, Canada, apply purely qualitative criteria (CICA,2002a) while others, such as, the UK, apply primarily quantitative criteria (ICAEW,2001). Yet others, such as New Zealand, apply a mix of qualitative and quantitative criteria (ICANZ,2002). In the USA, the differential reporting threshold is determined primarily by entity form, that is, a public-non-public threshold (Edwards,2004:40). In effect, USA private companies can prepare their financial statements in accordance with OCBOA.

Some countries, such as New Zealand, have differential reporting requirements embedded in their legislative requirements. These provide differential reporting thresholds in addition to those contained in their standard-setting bodies' differential reporting pronouncements. This has the effect of creating multiple differential reporting thresholds. The IASB's preliminary view that national standard-setters or other regulatory authorities should determine which non-publicly accountable entities should be required or permitted to prepare their financial statements in accordance with IASB SME Standards, appears to support a flexible approach that takes account of socio-economic conditions of different jurisdictions (IASCF,2004:26).

The differential reporting threshold determinants applied by leading standard-setters are summarised in table 4-1.

During 2003, after the questionnaires upon which this dissertation is based were received back from the respondents, the IASB began developing accounting standards appropriate for small and medium-sized entities (IASB SME Standards) (IASB,2003). The IASB's preliminary views expressly exclude the adoption of quantitative tests (IASCF,2004:para26) and instead apply the principle of no public accountability, as more fully described in chapter 3, as the overriding characteristic for determining the threshold for the application of IASB SME Standards (para35). The IASB's preliminary view that national standard-setters or other regulatory authorities should determine which non-publicly accountable entities should be required or permitted to prepare their financial statements in accordance with IASB SME Standards, appears to make provision for financial reporting jurisdictions to set their own quantitative thresholds for the application of IASB SME Standards (para26). Further, some support for the implementation of local quantitative threshold determinants can be inferred from the IASB's

tentative conclusion that because IFRS are used in more than 100 countries, it is not feasible to develop a quantified size test that would be applicable in all of those countries (para27).

With effect from 2005, European Union (EU) securities exchange listed companies are required to prepare their consolidated financial statements in compliance with IFRS (IASB,2004b). This requirement may, at the discretion of EU member states, be extended to company financial statements and unlisted entities. Where member states choose not to extend IFRS to unlisted entities, entity form differential corporate reporting requirements will result. The form and content of such unlisted EU entities' financial statements shall be determined by the individual member states. Based on the vast historical diversity of financial reporting requirements between EU member states (Nobes,1999:23), this diversity could persist into the foreseeable future. The diverse form and content of globally significant standard-setter jurisdictions differential reporting options are analysed in the subsections that follow.

Table 4-1 International differential reporting thresholds

	United Kingdom	**Australia**	**New Zealand**	**Canada**
Qualitative:	Specific exclusions: public companies, banks, insurance entities (ICAEW,2001)	Not a reporting entity (that is, no external users who depend on the financial statements for economic decision making) (AARF,1990)	No public accountability and all owners are members of the governing body (ICANZ,2002) or	Non-publicly accountable enterprise and all owners are members of the governing body (CICA,2002a)
Quantitative:	Does not exceed two or more of: - Revenue £2,8m - Assets £1,4m - Employees 50 (ICAEW,2001)	Does not exceed two or more of: - Revenue < $10m - Assets < $5m - Employees < 50 (SAICA,2001b:2)	No public accountability and does not exceed two or more of*: - Revenue $5m - Assets $2,5m - Employees 20 (ICANZ,2002)	

* The quantitative test does not apply where the entity does not have public accountability and at balance sheet date all of its owners are members of the entity's governing body.

Note: All amounts are denominated in the currency of the country concerned.

4.3.3 Form

4.3.3.1 Other comprehensive bases of accounting

By law, US GAAP is only applicable to public companies (Mersereau,2002:30). Most unlisted entities in the USA therefore qualify to prepare their financial statements on a comprehensive basis of accounting other than US GAAP, in many cases a tax basis (Martin,2000:48).

In the historical overview subsection, it was established that other comprehensive bases of accounting are also applicable to Australian companies that are not reporting entities.

4.3.3.2 Standalone SME Standards derived from GAAP

In Great Britain, Northern Ireland and the Republic of Ireland, differential reporting standard FRSSE is a standalone financial reporting standard that summarises UK and Irish GAAP and which focuses on reducing disclosure requirements rather than changing the measurement rules for small company transactions (ICAEW,2001).

In accounting for transactions or events not dealt with by FRSSE, a company reporting in accordance with FRSSE applies management judgement as to what constitutes generally accepted accounting practice rather than a mandatory fallback to UK GAAP. This is an important difference between this form of differential reporting and that of limited formalised deviations from GAAP discussed below.

4.3.3.3 Limited formalised deviations from GAAP

Although Canada and New Zealand each have a unitary set of GAAP for all entities, significant exemptions from the requirements of GAAP are granted to those entities that qualify to prepare their financial statements in accordance with differential reporting options (CICA,2002a; ICANZ,2002). Qualifying entities may selectively apply these differential reporting options. Full GAAP is applied in all instances where a differential reporting option does not exist.

4.3.3.4 Unlimited deviations from GAAP

The second differential reporting threshold in New Zealand provides that very small New Zealand companies need only present their financial statements in compliance with the matters

prescribed by the Governor-General by Order of Council (ICANZ,2002:para4.7). In effect, very small New Zealand companies are almost unlimited in the degree to which their financial statements may differ from New Zealand GAAP.

4.3.4 Detailed differential reporting options

The content of non-public USA corporate entities' financial statements is determined by the other comprehensive basis of accounting selected by that entity for the purposes of preparing its financial statements, for example, tax basis, cash basis, modified cash basis of accounting (Edwards,2004:40).

In Great Britain, Northern Ireland and the Republic of Ireland, qualifying entities that prepare financial statements in accordance with FRSSE, are not required to prepare a cash flow statement, and are granted significant presentation and disclosure concessions and a few simplifications as to how some transactions are recorded and measured. Despite this, many commentators are disappointed that the standard is not more radical in its approach (McAleese,2001:18). McAleese (18) reports that the results of a study in 2000 of accountancy practices in Ireland revealed that FRSSE had not relieved the financial reporting burden and that only forty-four percent of respondents used FRSSE in the preparation of some or all of their small company client accounts. FRSSE was revised again in December 2001 (ICAEW,2001). The relatively minor revisions are, in the author's opinion, unlikely to radically impact on the matters reported by McAleese.

New Zealand companies that qualify for differential reporting can elect full exemption from four standards namely (ICANZ,2002:appendix):

- FRS 10 - Statement of cash flows;
- SSAP 12 - Accounting for income taxes;
- SSAP 23 - Financial reporting for segments; and
- FRS 31 - Disclosure of information about financial instruments.

Further qualifying entities may elect partial exemption from a further thirteen standards. Some of the recognition and measurement exemptions include (ICANZ,2002:appendix):

- FRS 3 - Accounting for property, plant and equipment, the adoption of depreciation rates applicable for income tax purposes.

- FRS 13 - Accounting for research and development activities, the election to expense all research and development costs.
- FRS 14 - Accounting for construction contracts, the election to recognise profits on the completed contract method.

Canadian entities that qualify for differential reporting options may selectively elect individual exemptions and alternative treatments of six statements, four of which have substantial measurement implications. Mersereau (2002:30) summarised the Canadian differential reporting options that have measurement implications as follows:

- Section 1590 - Subsidiaries: use of the equity method or the cost method
- Section 3050 - Long-term investments: use of the cost method
- Section 3055 - Interest in joint ventures: use of the equity method or the cost method
- Section 3465 - Income taxes: use of taxes payable method.

DRAC's input into subsequent pronouncement issued by CICA resulted in issuance of the following additional Canadian GAAP that have differential reporting options with measurement implications (Edwards,2004:38):

- Section 3062 - Goodwill and other intangible assets; and
- Section 3855 - Financial instruments: recognition and measurement.

In the author's opinion, Canadian differential reporting measurement options set a meaningful precedent that provide substantial cost savings to Canada's smaller companies.

The diverse international differential reporting practices summarised and analysed in this subsection have been influenced by the international research that is reported on in the next section.

Table 4-2 International differential reporting relief			
	United Kingdom	**New Zealand**	**Canada**
Relief from presentation and disclosure requirements of GAAP	Yes	Yes	Yes
Alternative measurement models	No	No	Yes
Permits use of the cost model for long-term investments, that is, certain financial instruments	No	No	Yes
Relief from the requirement to:			
• provide for deferred taxation	No	No	Yes
• prepare a cash flow statement	Yes	Yes	No
• prepare consolidated financial statements	No	No	Yes
• prepare segment disclosures	No	Yes	No
• prepare financial instrument disclosures	No	Yes	No

4.4 International research

4.4.1 Historical overview

Early studies into differential corporate reporting found little support for differential corporate reporting, for example, Calderon (1990), Carsberg *et al* (1985) and Stanga and Tiller (1983). These studies typically applied entity size and ownership characteristics as the differentiating factors in their research.

Later studies (Holmes *et al*,1991; SAICA,2000b) found increased support for differential reporting. However, little consistency was found in appropriate threshold, form and content that differential reporting should take.

Recent differential corporate reporting pronouncements, for example, CICA (2002a); ICANZ (2002) and IASCF (2004), show a shift away from quantitative tests toward public accountability as the appropriate differential reporting threshold determinant. Further, although resistance to the relaxation of recognition and measurement persist, for example, IASCF (2004), as a result of new research some jurisdictions, for example CICA (2002a) and ICANZ (2002),

have implemented meaningful recognition and measurement differential reporting options for qualifying entities.

International consistency in differential reporting practices is currently being addressed by the IASB which is in the process of researching and developing IASB SME Standards for global application (IASCF,2004).

The key international research studies discussed below are set out in chronological order.

4.4.2 The Abdel-Khalik study (United States of America)

In the USA, differential reporting was debated in the 1980's (Calderon:1990; Hepp & McRae:1982; Mosso:1983; Stanga & Tiller:1983). By 1983, the FASB had addressed the presentation and disclosure aspects of a number of its pronouncements but was reticent to institute differential recognition criteria and measurement bases for small companies (Carsberg *et al*,1985:21).

A comprehensive study undertaken by Abdel-Khalik was reported on by the FASB in 1983. This research surveyed samples of managers, bankers and accountants by postal questionnaire and interview. The research main findings of this research study were (Carsberg *et al*,1985:22-23):

- Managers are the main users of small companies' financial statements;
- While users prefer financial statements prepared in accordance with full GAAP, as compared to another comprehensive basis, they believe the requirements of certain accounting standards to be excessive, for example, deferred tax;
- Increasingly complex GAAP was seen to be causing about twenty percent of the increase in accounting fees over the two year period prior to the study;
- Accountants were on average spending only fifty-nine percent of the estimated ninety-one hours per annum required to keep up with the changes in GAAP;
- Reasons for the financial statements of small companies not complying with GAAP were primarily the complexity of the standards and the accountant making the financial statements more relevant to management decisions. The cost of complying with GAAP was less frequently cited as a reason; and

- Accountants and bankers disagreed over the need for differential corporate reporting. Generally, accountants support the notion while bankers felt that the same information was needed irrespective of the size of the company.

Since the 1980's, smaller business entities in the USA use a comprehensive basis of accounting other than GAAP for preparing their financial statements, in many cases a tax basis (Martin,2000:48). Currently there is little interest in differential reporting in the USA as, by law, their accounting standards are only applicable to public companies (Mersereau,2002:30).

4.4.3 The Carsberg *et al* study (United Kingdom)

Carsberg *et al* (1985) undertook an extensive multifaceted research study into the issues of differential reporting in the UK. This research included interviews with managers (26-48), a survey of auditors (49-70) and a survey of accounts (71-78). Carsberg *et al* identified key arguments against differential corporate reporting as (1):

"1. ... if a certain standard is required to show a true and fair view for large companies, it must be needed equally to show a true and fair view for small companies.
2. ... universal application of standards is needed if large companies' accounts are to be comparable with those of small companies'.
3. A distinction among companies according to size is bound to involve an arbitrary cut-off, and that would be hard to defend."

Carsberg *et al* identified key arguments in favour of differential corporate reporting as (1-2):

"1. The concept of a true and fair view is modified by cost-benefit considerations to some extent ... Standards should impose fewer requirements on small companies than large companies because preparation costs are relatively heavy for small companies and the benefits are relatively low.
2. The users of small company accounts are predominantly different kinds of people with different kinds of needs from the users of large company accounts; consequently, no practical need exists for comparability.
3. Some standards will be ignored by small companies with the effect of bringing the standard-setting process into disrepute."

The research methodology followed by Carsberg *et al* was a structured interview based on a pre-prepared questionnaire (4). The questionnaire was administered to a sample of fifty managers of small companies that were selected from the yellow pages of the telephone directories for London and Leicestershire. The same questionnaire was also administered to fifty firms of accountants dealing with small companies, primarily the accountants of those businesses selected for the yellow pages. The financial statements of the fifty businesses selected were also reviewed for compliance with UK GAAP and the Companies Act (5).

The results of the study revealed that management viewed the production of annual financial statements as a relatively insignificant problem faced by the business. However, this may partly be because the function of preparing financial statements was generally found to be carried out by the entities' independent auditors (5). Both management and the auditors viewed management to be the most important user of 'small' company financial statements (7). Other significant users that were identified were banks and Inland Revenue.

Carsberg *et al* found managers to have too low a level of awareness of UK GAAP to give an informed opinion on specific standards (6) and consequently used auditors as their main source of information about attitudes to specific statements (8). Based on an analysis of auditors' responses to questions about the applicability of seven statements to small businesses and the estimated incremental cost of complying with them, Carsberg *et al* concluded that small companies should be required to comply with those standards that deal with fundamental topics. However, consideration should be given to exempting small companies from the requirements of those statements that have minor importance to a small company (13). Carsberg *et al* identified the following statements the requirements of which exemption should be considered for small companies:

- SSAP 1 - Accounting for the results of associated companies,
- SSAP 13 - Research and development expenditure,
- SSAP 15 - Accounting for deferred taxation, and
- SSAP 20 - Foreign currency translation.

Carsberg *et al* (14) further recommended that, in accordance with the results of future cost-benefit constraint studies, consideration should be given to exempting small companies from standards that deal with complex issues that extend the scope of existing accounting practices. This principle is evident in twenty-first century standards, notably with respect to earning per share and segment reporting. In applying the cost benefit constraint Carsberg *et al* (19-20) identified the following relevant costs:

- Direct costs, for example, compliance with a particular standard may result in increased bookkeeping costs and increased charges from external accountants;
- Opportunity costs, that is, the profit given up as a result of the need to comply with a particular standard, for example, potentially billable staff hours;

- Direct disclosure burden, for example, loss of competitiveness through disclosures that are useful to competitors; and
- Additional costs, for example, where a particular standard prescribes a particular accounting treatment that is different to that by which the entity evaluates its performance, it may necessitate the production of more than one set of accounts.

In the preface of the book in which the research findings of their study was published, Carsberg states (vii-viii) "Different conclusions can be drawn from the findings. Some may conclude that all standards and other disclosure rules should be applied to all companies, large and small, uniformly, backed by enforcement procedures and disciplinary action; others may argue that the results indicate the need to remove small companies from the jurisdiction of accounting standards altogether. The research team does not accept either of these extremes; but we do see the need for careful consideration of the applicability of each standard to small business ..."

Carsberg *et al* (91) concluded "We do not believe that a case exists for exemptions from all accounting standards of all companies below a certain size or of all private companies. Nor do we think that a separate code of generally accepted accounting principles for such companies should be considered, even if that approach is not ruled out by company law." However, Carsberg *et al* did go on to recommend (92) "Where a standard would have minor importance for a small company, because small companies rarely undertake the transaction dealt within the standard, consideration should be given to the exemption of small companies..." and (93) "The application of other standards to small companies, particularly those dealing with complex issues ..... The Committee should be prepared to give exemptions to small companies if the evidence indicates that costs would exceed the benefits."

With respect to differentiating between the measurement and disclosure requirements of GAAP for the purposes of relieving small entities from the presentation requirements only, Carsberg *et al* (2) argue that once measurements have been made of items affecting the financial statements, disclosure adds little to the burden. Thus, only exemption from supplementary disclosures, such as exemption from the requirement to prepare a supplementary current cost income statement, might provide relief to small entities, as that presumably would also preclude the need for measurement.

In the nearly two decades since this study was undertaken, both the volume and the complexity of GAAP has increased significantly which may have resulted in different conclusions particularly regarding the applicability of UK GAAP to small businesses. Evidence to this effect is found in a less comprehensive study conducted in 2000 by McAleese (2001:18) of

accountancy practices in Ireland which revealed that FRSSE had not relieved the financial reporting burden faced by small businesses.

4.4.4 The Holmes *et al* study (Australia)

In 1988, the Australian Accounting Research Foundation (AARF) released Exposure Draft 48 - Proposed statement of differential reporting (ED 48). The issuance of ED 48 prompted Holmes *et al* to investigate, by means of a postal survey, Australian practising accountants' perceptions of the applicability of Australian accounting standards to entities varied by size and legal structure (Holmes *et al*,1991:125).

The primary question in Holmes *et al's* research involved the evaluation of the applicability of the 23 existing Australian accounting standards to each of six hypothetical entities varied by size and legal structure, as follows (128):

- Entity A: Publicly listed company with an annual turnover of $10 000 000.
- Entity B: Publicly listed company with an annual turnover of $500 000 000.
- Entity C: Private company with an annual turnover of $100 000.
- Entity D: Private company with an annual turnover of $50 000 000.
- Entity E: Sole trader with an annual turnover of $50 000.
- Entity F: Sole trader with an annual turnover of $200 000.

Holmes *et al* (1991:130) conclude that the result of their survey of Australian practising accountants supports differential reporting on the basis of both size and legal structure. With respect to size, a higher overall acceptance of GAAP was found for the three largest entities when compared with the smallest (128). Size variations of public companies and sole traders revealed no overall significant differences. However, significant differences were found at the ninety-five percent level of confidence in respect of private companies varied by size, suggesting that private companies with low levels of turnover are classed in the same category as sole traders.

Holmes *et al* found little support for the tax basis of accounting for small companies (130) which was in contrast with the actual practice of accountants identified by researchers such as McCahey & Ramsey, in jurisdictions where the income tax basis is permitted as a basis for the preparation of private company financial statements (129). Holmes *et al* found support for a formal set of differential reporting requirements for the financial statements of smaller

companies, with only four of the twenty-three standards tested being found appropriate to the financial statements of small private companies and sole proprietors. These four standards are generally applicable and relate primarily to the measurement and presentation of profit or loss for the period, namely:

- AAS 1 - Profit and loss statement;
- AAS 2 - Valuation and presentation of inventories;
- AAS 4 - Depreciation of non-current assets; and
- AAS 5 - Materiality of financial statements.

All standards were found to be appropriate for public companies and all but two, namely, AAS 14 - Equity accounting and AAS 16 - Segmental reporting, were found to be appropriate to large private companies (130). In South Africa, segment reporting is not required in respect of unlisted entities (SAICA,1998b).

4.4.5 CICA's research report (Canada)

In 1999, CICA's Accounting Standards Board's (AcSB) commissioned research report - Financial reporting by small business enterprises, was published (Mersereau,2002:31). The report examined how the financial information needs of providers of capital to small business enterprises (SBEs) might be more effectively met, and the degree to which Canadian GAAP could be modified to meet those needs (Lavigne,1999:49). The study group defined SBEs as "entities other than public enterprises, cooperative organizations, pension plans and financial institutions." The research methodology adopted included a review of the available literature, communicating with relevant standard-setting bodies, and instituting a consultation process involving users of SBE financial reports and practitioners. Lavigne (49-50) summarised the main findings of the report as follows:

- Users of SBE financial statements were found to be few in number.
- Users of SBE financial statements consisted primarily of bankers, owner/managers, tax authorities and less frequently, venture capital providers.
- SBEs prepare GAAP financial statements primarily to meet their bankers' needs.
- Although changing, financial statements still play a major role in bankers' decisions concerning large loans where the entity's cash flows will provide for repayment.
- Practitioners perceived some of the information required under GAAP to be of little relevance to SBEs.

- The information needs of the users of SBE financial statements regarding the SBE's ability to provide a return on investment and the stewardship of its management, are less significant than those of financial market investors.
- The only form of differential reporting that is acceptable to SBE financial statement users is a single set of GAAP with differential rules for SBEs. However, GAAP should be sufficiently flexible to ensure that SBEs are not subjected to requirements that do not meet the needs of their users. This finding is particularly relevant as the study group perceived some accounting standards to be designed primarily to meet the needs of public enterprises and they perceive this likely to intensify in the future.

As a result of its findings, the study group made the following recommendations (50):

- A differential accounting principle should be established within GAAP such that SBE reporting requirements would differ from full GAAP when full GAAP does not meet SBE financial reporting needs or when the cost of applying full GAAP outweighs the potential benefits.
- Normally, differential reporting would apply only to presentation and disclosure.
- Except for their derivative financial instruments, exempt SBEs from disclosures about the fair value of financial instruments, financial assets carried at an amount in excess of fair value, or about interest rate risk.
- Simplify SBE disclosure requirements for discontinuing operations, share capital, related party transactions, long-term debt with covenant violations and goodwill.
- The possibility of recognition and measurement differential reporting requirements should be examined on a case-by-case basis.
- Exempt SBEs from classifying financial instruments as equity or liability.
- Financial statement concepts, that is, section 1 000, be amended to reflect that cost-benefit considerations may differ where the reporting entity is a SBE.
- Implementation guides for SBEs be prepared under the AcSB's supervision to help enterprises understand and apply complex new accounting standards.
- A SBE consultative committee be established that reports to the AcSB to provide it with timely advice on SBE financial reporting needs and the impact that proposed GAAP would have on SBEs.
- Some of the members of the AcSB should have extensive experience with SBEs.

In accordance with the recommendations of the study group's report, the AcSB established a standing committee to provide input into the standard-setting process from a non-public

enterprise perspective (Mersereau,2002:31). This process resulted in the issuance of an exposure draft that proposed differential reporting for Canadian companies. Although the exposure draft generated some controversy, it was generally well supported.

In 2002 Canadian differential reporting was implemented allowing selective application of the individual exemptions and alternative treatments of six statements, namely (Mersereau,2002:30):

- Section 1590 - Subsidiaries: use of the equity method or the cost method
- Section 3050 - Long-term investments: use of the cost method
- Section 3055 - Interest in joint ventures: use of the equity method or the cost method
- Section 3240 - Share capital: limitation of the disclosure to issued classes of shares
- Section 3465 - Income taxes: use of taxes payable method
- Section 3860 - Financial instruments - disclosure and presentation:
  Presentation of redeemable preferred shares issued in specified tax planning arrangements as equity and the limitation of fair value disclosures to financial assets and liabilities for which fair value is readily obtainable.

Four of CICA's differential reporting options have substantial recognition and measurement implications.

Canadian differential reporting options with measurement implications were subsequently extended in respect of (Edwards,2004:38):

- Section 3062 - Goodwill and other intangible assets; and
- Section 3855 - Financial instruments: recognition and measurement.

The Canadian approach to differential reporting is considered influential internationally. Most notable are preliminary indications that the IASB's SME project that is discussed in the next subsection is conceptually similar to that adopted by the CICA in Canada (Edwards,2004:40).

4.4.6 International

4.4.6.1 Background

The issue of differential reporting is emerging at the international level (Mersereau,2002:30). Accounting by small and medium-sized entities and in emerging economies, is currently an active research topic of the IASB. The United Nations Intergovernmental Working Group on International Standards of Accounting and Reporting (ISAR) is engaged in developing a model framework for national accounting regulators that will cover the whole range of accounting entities from the one-person business through to the listed company. Should the IASB issue IASB SME Standards, this could dramatically improve international convergence as more than one hundred countries, including South Africa, use IFRS (IASCF,2004:para27). However, the adoption of IFRS by a country does not imply that IASB SME Standards will also be adopted by that country. In 2003, to establish the extent of existing international differential reporting practices and national standard-setter perceptions of how the IASB should address differential reporting, the IASB surveyed forty of the world's national standard-setters (Pacter,2004:118).

4.4.6.2 Respondents

Seventy-five percent of the national standard-setters surveyed responded to the IASB's survey (IASCF,2004:para11). According to Pacter (2004:118), the respondents listed in table 4-3 represent a large cross-section of the global economy.

Table 4-3 Respondents to the IASB survey

The following national accounting standard-setters responded to the survey:

Australia	Iran	Poland
Canada	Italy	Russia
China	Japan	Singapore
Denmark	Korea	South Africa
Europe	Malaysia	Spain
France	Moldova	Sri Lanka
Germany	Netherlands	Sweden
Hong Kong	New Zealand	Thailand
Hungary	Norway	UK
Indonesia	Pakistan	US

Source: Pacter (2004:118)

The standard-setter denoted as Europe in table 4-3 is the European Financial Reporting Advisory Group (EFRAG) that responded from the perspective of the European Union directives (Pacter,2004:118).

4.4.6.3 Desirability

All companies in sixty-seven percent of the respondent jurisdictions were found to have a legal requirement to prepare financial statements in accordance with GAAP. In a further twenty-seven percent of respondent jurisdictions, only very small companies were exempt from compliance with national GAAP (119).

Thirty-three percent of the respondent jurisdictions were found to have a separate set of national GAAP for SMEs. A further seventeen percent were found to be in the process of developing separate SME GAAP and fifteen others were found to have SME differences in their national GAAP (119).

4.4.6.4 Form

The survey did not solicit standard-setters' views of the appropriate form that IASB SME GAAP should take. Instead, respondents were asked how IASB SME Standards should be published. Fifty-seven percent of the respondents expressed a preference for IASB SME Standards being published as a standalone document. Eighteen percent preferred separate sections within each individual IFRS. Twenty-five percent expressed a preference for both of the aforementioned forms (119). This preference is largely inconsequential as it reflects the physical form that IASB SME Standards should take rather than its content or application.

4.4.6.5 Content

Ninety percent of the respondent jurisdictions were found to have presentation and disclosure differences for SMEs in their national GAAP. However, ninety-seven percent of the respondents perceived it appropriate that IASB SME Standards should include presentation and disclosure simplifications. The presentation and disclosure simplifications for SMEs that the IASB found to exist in the 2003 national GAAP of the respondent standard-setters are presented in table 4-4.

Sixty percent of the respondent jurisdictions were found to have recognition and measurement differences for SMEs in their national GAAP. However, eighty percent of the respondents perceived that IASB SME Standards should include recognition and measurement simplifications. The recognition and measurement simplifications for SMEs that the IASB found to exist in the 2003 national GAAP of the respondent standard-setters are presented in table 4-5.

Table 4-4 Existing presentation and disclosure simplifications in national GAAP

- Abbreviated financial statements.
- Omit the cash flow statement.
- Omit the statement of equity.
- Omit a statement of comprehensive income.
- Exempt from preparing consolidated financial statements.
- Omit reconciliations of tangible and intangible assets.
- Omit or reduce disclosures of:
  - management remuneration
  - fair values of financial assets and liabilities
  - provisions
  - impairments
  - related party relationships and transactions
  - income taxes
  - depreciation
  - discontinued operations
  - inventory and cost of sales
  - asset disposals
  - average number of employees
  - contingencies
  - derivatives and other financial instruments
  - research and development charged to expense
  - pro forma business combination information.
  - pensions and other employee benefits.

Source: Pacter (2004:119)

Table 4-5 Existing recognition and measurement simplifications in national GAAP

- Use of the cost method for unconsolidated subsidiaries and associates.
- Use of the tax payable method for income taxes.
- Reduced frequency of testing for impairment of goodwill and intangibles.
- Calculate ending inventory at selling price less costs to complete and normal profit.
- Use the depreciation method and rates that tax law allows.
- Cash basis of accounting adjusted to restore receivables and payables at the end of the period.
- Charge debt discount or premium directly to expense at acquisition or issuance date.
- Straight-line interest recognition rather than the effective interest method.
- Do not use the percentage-of-completion method for contracts.
- Do not use the percentage-of-completion method for service revenue.
- Need not include production overheads in costs of manufactured inventories.
- Measure foreign currency transactions at settlement amount (no foreign exchange gain/loss).
- Account for all leases as operating leases.
- Do not recognise pension or other employee benefit.
- Simplified calculation of employee benefit obligations.
- Use pooling-of-interests method for mergers of two SMEs.
- Use simplified derecognition provisions rather than those in IAS 39 - Financial instruments: recognition and measurement.
- Use simplified hedge accounting provisions rather than those in IAS 39.
- SMEs are exempted from using the equity method of accounting for associates.
- For a finance lease, measure the asset at fair value, not discounted present value.
- Amortise goodwill and other indefinite life intangibles, rather than non-amortisation plus an impairment test.
- Do not recognise share-based payment costs.
- Measure share-based payment costs by the minimum value method rather than fair value.
- Do not capitalise development costs.
- Carry investment property at impaired cost rather than fair value.

Source: Pacter (2004:119)

4.5 South African efforts

4.5.1 Background

Charles Hattingh spearheaded public debate, albeit from a proponent's perspective, on differential corporate reporting Accountancy SA's monthly column - Straight talking (1999, 2001, 2002a, 2002b) and at the SAICA technical update seminars that he presented. Hattingh (1999:21) refers to having tried and failed to set up a petition for a two-tier system of GAAP some years previously but was astonished by the obvious groundswell of opinion on the matter at the 1998 SAICA update seminars. In 2000, the SAICA responded by issuing discussion paper 16 - Limited purpose financial reporting standards (DP 16) (SAICA,2000b).

4.5.2 Discussion paper 16

In DP 16, the SAICA acknowledged the results of Hattingh's study (4). SAICA reported that participants indicated strong support for maintaining the recognition and measurement standards of SA GAAP for limited purpose financial statements, but confirmed that there was a real need to reduce the burden of excessive disclosures. The SAICA supported this stance with the following reasons:

- South Africa does not have the resources to reinvent recognition and measurement standards – it has taken years for the IASC to arrive at its standards, which have been adopted in over seventy countries around the world.
- One set of standards is required for analysing and benchmarking the financial position and results of an enterprise. Benchmarking is necessary for measuring stewardship, assessing loan applications, and valuing the securities of an enterprise.
- Auditors will have to report on the financial position, cash flows and results of operations of all companies. They need to have authoritative measurement and recognition standards in order to formulate their opinion.
- If an enterprise that prepares limited purpose financial statements ever needs to prepare general purpose financial statements, no changes in accounting policy will be required.
- The South African Revenue Services (SARS) bases many tax principles on standards in SA GAAP and SARS uses the annual financial statements as the starting point for assessing tax.
- The FRSSE does permit a lower level of recognition and measurement in certain instances, which has been the subject of much criticism in England. Canada, on the other hand, will probably only be reducing the level of presentation and disclosure.

The basis for the determination of the differential reporting threshold proposed in DP 16 was companies that are closely held and controlled by owners and whose financial statements are only available to a limited user audience. Further, the SAICA proposed that these financial statements should be clearly identified as limited purpose financial statements.

Since May 2000, much has changed: (i) FRSSE has been revised (ICAEW,2001) to extend its exemptions to qualifying companies in Great Britain and Ireland; (ii) the AcSB issued section 1 300 that allows substantial recognition and measurement concessions to Canadian qualifying entities (CICA:2002a); (iii) unprecedented financial reporting scandals erupted in the USA, for example Enron and Worldcom, as a result of which the international accounting practice Arthur Andersen was disbanded; and (iv) the IASB placed differential reporting on their active research programme (IASB,2003).

4.5.3 Hattingh

Not satisfied with the proposals of DP 16 Hattingh (2002b:23) surveyed 2 286 participants at SAICA's 2001 accounting technical update. The results of that survey found strong support for differential reporting taking the form of: (i) SA GAAP with limited flexibility, whereby standard-setters would limit the permissible deviations that qualifying companies may elect to follow, or (ii) unlimited flexibility, whereby preparers of financial statements would decide upon deviations from SA GAAP and would merely be required to make suitable disclosure thereof. Hattingh acknowledged that he influenced the results to the extent that the allocation between the two options may be unreliable.

The results did not support differential reporting taking the form of either a separate set of standards for qualifying companies or SARS GAAP.

4.5.4 Cleminson and Rabin

Cleminson and Rabin (2002) investigated auditors' perceptions of reporting problems faced by small business entities in South Africa. Their study identified the most significant financial reporting problems faced by small business as: (i) the costs of compliance with SA GAAP; and (ii) the inability of financial statements to meet the needs of their users.

The results of the phenomenological study were determined by intuitive analysis of only eight subjectively selected willing participants from within one strata of auditors, namely, smaller audit firms. The results must therefore be interpreted with caution.

4.5.5 The draft financial reporting bill

In anticipation of differential reporting, the draft financial reporting bill (draft bill) and the consequential draft amendments to the Companies Act were proposed to make provision for South African limited purpose financial statements (SAICA,2002c). The memorandum on the objects of the draft bill acknowledges that it is neither reasonable nor practicable to require small enterprises to comply with reporting standards that are based on general international reporting standards (SAICA,2002d).

In accordance with the draft bill, limited purpose financial reporting standards means the financial reporting standards set for the preparation and presentation of financial statements of an entity where:

- there is no person who in terms of any Act is entitled to receive financial statements of the entity that have to rely mainly or solely on those financial statements for financial information regarding the entity; or
- persons who in terms of any Act are entitled to receive financial statements of the entity that have to rely mainly or solely on those financial statements for financial information regarding the entity, have waived, in accordance with an Act, their right to receive general purpose financial statements from that entity and have consented to the issuing of them as limited purpose financial statements.

The draft bill further proposes that a financial reporting standards council (the council) be established. Included in the proposed functions of the council is the setting of limited purpose financial reporting standards laying down the minimum requirements for recognition, measurement, presentation and disclosure for such financial statements (SAICA:2002c).

The proposed amendments to the Companies Act clarify that a private company may prepare limited purpose financial statements provided that it is authorised annually by a resolution passed by all its members at a general meeting of the private company or in a document signed by all of its members (SAICA:2002c).

4.6 Summary

This chapter summarised key international differential corporate practices and research studies. Global acceptance was found for IFRS (or national GAAP) for the preparation of the general purpose financial statements of securities exchange listed entities. Further, the national GAAP of most countries is currently in the process of being harmonised with IFRS, which in turn is currently engaged in a joint harmonisation programme with FASB. From 2005, many jurisdictions' national GAAP will be superseded by IFRS. Unprecedented global uniformity is therefore imminent for general purpose financial statements. However, this uniformity was found not to extend to the differential reporting requirements of the jurisdictions examined.

In the twentieth century, the desirability of differential reporting requirements was doubtful. Some of the earlier research supported differential reporting options while others did not. After much debate, the USA, in 1978, was the first jurisdiction to implement differential corporate reporting, when it was legislated that only listed companies be required to prepare financial statements in accordance with US GAAP. This legislation remains in effect. Australia implemented differential reporting requirements in 1990, followed by New Zealand in 1994, the UK in 1997 and Canada in 2002. However, the differential reporting thresholds, form and detailed requirements differ substantially between the jurisdictions studied. In 2003 the IASB commenced its differential reporting project. The IASB's research found support for a global set of financial reporting standards for SMEs and fast tracked its IASB SME Standards project. In June 2004, the IASB exposed for public comment its preliminary views on differential reporting.

Global differential reporting thresholds remain an eclectic mix of criteria including amongst others, entity form, entity size, and public accountability. However, recent research and standard-setter pronouncements indicate a move away from entity size towards no public accountability, as the most theoretically defensible threshold determinant.

Global differential reporting options vary greatly. Some jurisdictions, for example the USA and Australia, permit qualifying entities to prepare their financial statements in accordance with other comprehensive bases that are totally divorced from their national GAAP. Other jurisdictions, for example Great Britain and the Republic of Ireland, have standalone GAAP for qualifying entities that is derived from national GAAP. The standalone GAAP for SMEs has substantial presentation and disclosure concessions and some limited measurement concessions. Yet other jurisdictions, for example Canada and New Zealand, allow qualifying entities meaningful targeted recognition and measurement concessions and substantial presentation and

disclosure concessions. In these jurisdictions, qualifying entities are granted full exemption from some reporting standards in their entirety and partial exemption from other reporting standards. In common with the approach adopted in Canada and New Zealand, the IASB's preliminary view is that targeted adjustments from IFRS is the appropriate form that differential reporting should take. The IASB is in the process of drafting IASB SME Standards that could be applied globally. Initial indications are that this project enjoys substantial support from national standard-setters.

Current differential reporting requirements vary widely around the world. National standard-setters apply different thresholds for differential reporting, adopt different forms of differential reporting and there is little commonality in the detailed differential reporting options of different jurisdictions. Even where national standard-setters adopt the same form of differential reporting, substantial differences in the detail occur. For example, under New Zealand differential reporting options, qualifying entities are exempted from the requirement to prepare a cash flow statement whereas their Canadian counterparts are not. The likely development of IASB SME Standards should greatly improve the consistency of differential reporting requirements globally.

While South Africa has been slow to address differential reporting, recent actions from government, that is the corporate law reforms, and from the SAICA, indicate that the matter is now being properly attended to. Differential reporting for South African entities appears to be imminent.

This analysis of global differential reporting practices and selected research presented in this chapter, together with the assessment of the limited South African research on the topic and the legal and proposed legal frameworks set out in chapters 2 and 3 respectively, form the basis from which the survey section of this research was devised.

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Chapter 5

RESEARCH METHODOLOGY

5.1 Introduction

It is apparent from the proposed legislation presented in chapter 3 that differential reporting probably will be implemented in South Africa in the foreseeable future. In chapter 4, prior research into South African differential corporate reporting requirements was reported and a summary of the global state of differential reporting was presented. It is apparent that dissatisfaction exists regarding the differential corporate reporting options in some of the countries in which it has been implemented. Further, there is little commonality between the differential reporting requirements of the reporting jurisdictions that have implemented differential reporting. South Africa's unique socio-economic conditions may also necessitate the implementation of differential corporate reporting requirements that are different to those of the developed western nations examined. Little scientific research has been conducted into South African differential corporate reporting requirements. Therefore, to enhance knowledge of differential corporate reporting in South Africa and to provide a basis for further research into the issues concerned, the remainder of this dissertation focuses on an investigation of the attitudes of South African registered accountants and auditors (RA&As) towards various aspects of differential corporate reporting in South Africa. This is presented below under the heading research objectives, questions and hypotheses.

Archival research was applied in chapters 2 to 4 to determine the theoretical basis for differential reporting, the state of its application globally, and the findings of prior research conducted on various aspects of the subject. This assisted in the conceptualisation of the postal opinion research to which the remainder of this dissertation is dedicated. In particular, the archival research assisted in:

- the formulation of research objectives, questions and hypotheses,
- provided a basis for comparing the findings of this study with those of prior studies, and
- provided a basis for comparing the proposed South African differential reporting practices with those currently adopted or proposed in other countries.

The process applied in the postal opinion research adopted in this dissertation, including the analysis of the data and the limitations of the study, form the content of this chapter. The

interpretation of the results and the drawing of conclusions from the research findings are presented in the chapters that follow.

5.2 Research objectives, questions and hypotheses

Given the widely acknowledged but poorly researched need for differential corporate reporting requirements in South Africa, the objectives of this study are to confirm the need for differential corporate reporting and to provide some insights into the desired form, content and applicability of South African differential reporting requirements. It is expected that the investigation will, together with more detailed user-focussed future research, provide guidance to those charged with the development of differential reporting laws and pronouncements in South Africa.

With the objectives of the research in mind, the following research questions were developed:

- Do public accountants perceive a need for differential corporate reporting?
- If differential corporate reporting is desirable, to which corporate entities do public accountants perceive it should be applicable?
- If differential corporate reporting is desirable, what do public accountants perceive the detailed requirements of differential corporate reporting should be?
- If differential corporate reporting is desirable, what form do public accountants perceive differential corporate reporting should take?

After due consideration, it was decided to limit the formally stated objectives of the study to the first two research questions and a single aspect of the third research question. The aspect of the third research question included in the formally stated objectives of the research is the globally controversial issue of whether differential reporting options for qualifying companies should be limited to presentation and disclosure issues or should be extended to include issues of recognition and measurement. To optimise the usefulness of the research, it was decided to include additional questions designed to collect information about other aspects of the third research question and to limited aspects of the last research question. This decision was necessary to limit the research to manageable proportions and to provide some information on the last research question that may be useful to future research.

In order to guide the direction of the study, identify the relevant facts, direct the form of research design, and provide a framework for the results (Cooper & Schindler,2001:49) the following hypotheses were developed:

H1: Public accountants do not believe that all South African corporate entities, irrespective of their size, legal form and user base, should be required to prepare their financial statements in compliance with SA GAAP.

Null Public accountants believe that all South African corporate entities, irrespective of their size, legal form and user base, should be required to prepare their financial statements in compliance with SA GAAP.

H2: Public accountants believe that a single differential reporting threshold is appropriate in the South African context.

Null Public accountants do not believe that a single differential reporting threshold is appropriate in the South African context, that is, they believe that multiple differential reporting thresholds are appropriate in the South African context.

H3: Public accountants believe that differential corporate reporting requirements should be applicable to both the presentation and disclosure requirements of SA GAAP and to the recognition and measurement requirements of SA GAAP.

Null Public accountants believe that differential corporate reporting requirements should be limited to the presentation and disclosure requirements of SA GAAP only, that is, differential reporting options should not extend to the recognition and measurement requirements of SA GAAP.

As this research is a pioneering effort to promote knowledge of issues that have never previously been scientifically explored in the South African context, the hypotheses were formulated taking account of similar studies undertaken in countries when differential corporate reporting was being conceived. This further facilitates the comparison of the finding of this study with those previous overseas studies.

5.3 Selection of the target group

RA&As were selected as the population as they are exclusively qualified to perform the attest function on South African companies. It can therefore reasonably be assumed that: (i) they are knowledgeable of the requirements of SA GAAP; and (ii) they have an understanding of their clients' information needs and the needs of other users of corporate financial statements. Further, Carsberg, Page, Sindall and Waring (1985:8) justify the use of auditors as their main source of information about attitudes to specific accounting standards on managers' lack of

knowledge about accounting standards. The use of RA&As also provides a convenient sampling frame.

5.4 Research design and sampling

The use of RA&As as the population provided a convenient sampling frame, that is, the PAAB's alphabetical list of RA&As at 31 March 2002. This list contains the total population of four thousand seven hundred and seventy seven RA&As at 31 March 2002. A sample size of three hundred and fifty three was determined with reference to a generalised scientific guideline for sample size decisions. A random number generator was used to select a simple random sample of three hundred and fifty three RA&As from the uniquely numbered sampling frame. Selection of a simple random sample ensured coverage of all sizes and locations of auditing firms in South Africa.

5.5 The measuring instrument

5.5.1 Layout

The postal questionnaire has four main sections. The first section is designed to collect biographical information about the respondent. The second section elicits responses to the perceived need for differential reporting. The third section elicits responses to the most desirable framework that differential corporate reporting may take. The fourth section is designed to collect information about the desired content of differential reporting and to establish if one or more thresholds for differential reporting are perceived to be appropriate in the South African context. The design of this section is adapted from that followed by Holmes, Kent and Downey (1991:128) who acknowledge an earlier study by Knutson and Wichmann in this respect.

5.5.2 Question choice

The questionnaire was divided into four main sections identified in 5.5.1 layout above. The following discussion substantiates the questions used in each of the four sections of the questionnaire.

5.5.2.1 Respondent demography

In order to maximise the response rate, biographical information was limited to that which was considered essential in providing additional information on the attitudes of RA&As to differential reporting. Questions were therefore limited to the respondents' experience and practice size.

The RA&As were questioned on their experience by means of the following question:

Which category best describes the number of years that you have been registered with the Public Accountants' and Auditors' Board? *(Please tick one)*

Less than 5 years ☐
5 to 10 years ☐
11 to 20 years ☐
More than 20 years ☐

The information obtained from the response to this question was cross-tabulated with selected other questions in the questionnaire to provide more meaningful information about the attitudes of RA&As to most aspects of differential corporate reporting included in this study. For the purposes of conducting statistical testing, the first three categories were merged so as to provide two categories, namely, twenty years or less experience and more than twenty years experience, with a reasonable number of respondents in each category.

The RA&As were questioned on the size of their practice by means of the following question:

Which category best describes the size of your practice? *(Please tick one)*

Large multinational (ie 'final four' + BDO + GTKF + etc) ☐
Large (multiple JSE Securities Exchange listed audit clients) ☐
Medium ☐
Small ☐

The information obtained from the response to this question was cross-tabulated with selected other questions in the questionnaire to provide more meaningful information about the attitudes of RA&As to selected aspects of differential corporate reporting included in this study. For the purposes of conducing statistical testing the three largest categories were merged so as to provide two categories, namely, large and small, with a reasonable number of respondents in each.

5.5.2.2 Desirability

To determine the need for differential corporate reporting in South Africa, RA&As were questioned on the need for differential corporate reporting by means of the following question:

Do you perceive a need for differential corporate reporting requirements in South Africa?
(Please tick one)

YES	NO

This question is fundamental to the questionnaire as responses to it are decisive for the rest of the questionnaire. Respondents were therefore asked to briefly support their answers to this question.

Support for differential corporate reporting would underpin in principle the current differential reporting proposals and serve as a basis for the recommendation of appropriate amendments to existing reporting requirements. Consideration of the reasons cited in support of differential corporate reporting are likely to be important inputs to the differential corporate reporting decisions of accounting standard-setters and other regulatory bodies.

A lack of support for differential corporate reporting would demonstrate that there is no need for differential reporting requirements in South Africa. Consideration of the reasons cited for maintaining the *status quo* are likely to be important inputs to the differential corporate reporting decisions of accounting standard-setters and other regulatory bodies.

5.5.2.3 Form

In view of the fact that differential reporting requirements are effective in many reporting jurisdictions and that the form of differential reporting varies widely from one jurisdiction to another (refer to chapter 4), South African RA&As' views of the form that South African differential corporate reporting should take were analysed. This analysis was limited to private companies in accordance with the recommendations of the draft financial reporting bill (refer to chapter 3). In selecting the possible alternative forms that South African differential corporate reporting may take, this research was informed by prior research (refer to chapter 4) and current global differential reporting proposals and practices (refer to chapter 4). To limit the length of the questionnaire so as to maximise the response rate, respondents were required to rate five

specified alternative forms of differential corporate reporting. To leave forms of differential corporate reporting open-ended, a sixth category, other specify, was included.

To determine their perceptions of the suitability of alternative forms that South African differential corporate reporting may take, RA&As were asked to complete the following:

How do you rate the suitability of each of the following possible forms of differential reporting for the limited purpose financial statements of a private company whose financial statements are only distributed to its shareholders and attached to its IT14 tax return? (that is, a narrow user base).
(Please circle only one number for each of a, b, c, d, e & f below)

		Very unsuit-able	Unsuit-able	Indiff-erent	Suit-able	Very suit-able
a.	The income tax basis (ie in accordance with tax law).	1	2	3	4	5
b.	The cash basis (ie record cash transactions only).	1	2	3	4	5
c.	Unlimited deviations from SA GAAP (ie the private company devises its own accounting policies without reference to SA GAAP).	1	2	3	4	5
d.	Limited formalised deviations from SA GAAP (ie each SA Statement of GAAP specifies exemptions from specific provisions).	1	2	3	4	5
e.	Completely separate set of SA GAAP for limited purpose financial statements.	1	2	3	4	5
f.	Other (specify)	1	2	3	4	5

The exercise was repeated in respect of a private company whose financial statements are used by its shareholders, its bankers and other financiers, its franchisor, SARS, other government agencies, etc? (Hereafter, a wide financial statement user base).

The alternative forms of differential corporate reporting were ranked using the mean values of the suitability ratings of the respondents. To determine if financial statement user base is perceived to be significant to differential reporting options, chi-square tests for significant differences between the responses for the two entity types examined were conducted. The result of this test may also be useful in determining which entities should qualify for differential reporting, that is, the threshold for differential corporate reporting.

To determine if current perceptions of the desirability of differential reporting options are different to those of prior research, chi-square tests for significant differences between the

responses to this study and the results of the Hattingh study (2002b) set out in chapter 4 were conducted.

The results of this aspect of this research are important as consideration of the weightings of different possible forms that South African differential corporate reporting may take are likely to be important inputs to the differential corporate reporting decisions of accounting standard-setters and other regulatory bodies.

5.5.2.4 Threshold

In view of the fact that the threshold for differential reporting varies widely from one jurisdiction to another (refer to chapter 4), and as the South African authorities and standard-setters are currently exploring differential corporate reporting options (refer to chapters 3 and 4), South African RA&As' views of the suitability to twelve hypothetical corporate entity types (see table 5-1 below) of selected statements of SA GAAP (see table 5-2 below) were analysed.

The primary questions in this section were in respect of twelve hypothetical entities varied by size, legal structure and user base, as set out in table 5-1 below. The choice of entity type was informed primarily by the prior research of Holmes *et al* (1991) modified for the South African context and extended to include user base.

Respondents were given a listing of twelve statements of SA GAAP (detailed in table 5-2). All statements of SA GAAP were not included in the questionnaire, as this would have made completion of the questionnaire too onerous. As differential corporate reporting is already effectively in existence in respect of those statements of SA GAAP with which unlisted entities are not required to comply, all such statements of SA GAAP were excluded. With the exception of AC 137, statements of SA GAAP that are industry specific were also excluded. AC 137 was included as agriculture is an important and widely distributed industry in South Africa, and the author therefore believes that most RA&As would have clients that are subject to AC 137.

Table 5-1 Hypothetical entities

Entity A:	JSE Securities Exchange listed company with an annual turnover of R3 000 million (Hereinafter: Big JSE listed).
Entity B:	JSE Securities Exchange listed company with an annual turnover of R60 million (Hereinafter: Small JSE listed).
Entity C:	Public company that is not listed on the JSE Securities Exchange with an annual turnover of R3 000 million (Hereinafter: Big public unlisted).
Entity D:	Public company that is not listed on the JSE Securities Exchange with an annual turnover of R60 million (Hereinafter: Small public unlisted).
Entity E:	Private company with an annual turnover of R300 million whose financial statements are made available only to its shareholders and attached to its IT14 tax return (Hereinafter: Big private no users).
Entity F:	Private company with an annual turnover of R300 million whose annual financial statements are widely distributed to various users including: its shareholders, its bankers and other financiers, its franchisor, SARS, other government agencies, etc (Hereinafter: Big private with users).
Entity G:	Private company with an annual turnover of R600 000 whose financial statements are made available only to its shareholders and attached to its IT14 tax return (Hereinafter: Small private no users).
Entity H:	Private company with an annual turnover of R600 000 whose annual financial statements are widely distributed to various users including: its shareholders, its bankers and other financiers, its franchisor, SARS, other government agencies, etc (Hereinafter: Small private with users).
Entity I:	Close corporation with an annual turnover of R300 million whose financial statements are made available only to its members and attached to its IT14 tax return (Hereinafter: Big CC no users).
Entity J:	Close corporation with an annual turnover of R300 million whose annual financial statements are widely distributed to various users including: its members, its bankers and other financiers, its franchisor, SARS, other government agencies, etc (Hereinafter: Big CC with users).
Entity K:	Close corporation with an annual turnover of R600 000 whose financial statements are made available only to its members and attached to its IT14 tax return (Hereinafter: Small CC no users).
Entity L:	Close corporation with an annual turnover of R600 000 whose annual financial statements are widely distributed to various users including: its members, its bankers and other financiers, its franchisor, SARS, other government agencies, etc (Hereinafter: Small CC with users).

Table 5-2 Relevant SA GAAP

AC 102 – Income taxes*
AC 105 – Leases*
AC 108 – Inventories*
AC 112 – Accounting for the effects of changes in foreign exchange rates*
AC 116 – Employee benefits*
AC 118 – Cash flow statements
AC 123 – Property, plant and equipment*
AC 125 – Financial instruments: disclosure and presentation**
AC 126 – Related party disclosure
AC 128 – Impairment of assets*
AC 129 – Intangible assets*
AC 130 – Provisions, contingent liabilities and contingent assets*
AC 132 – Consolidated financial statements and accounting for investments in subsidiaries
AC 133 – Financial instruments: recognition and measurement**
AC 135 – Investment property*
AC 137 – Agriculture*

* Respondents indicated the appropriateness of the presentation and disclosure requirements separately from the recognition and measurement requirements.

** Respondents indicated the appropriateness of the presentation and disclosure requirements separately from the recognition and measurement requirements collectively in respect of AC 125 and AC 133.

To determine their perceptions of the suitability of the requirements of SA GAAP to different corporate entities, and thereby to determine what RA&As perceive the appropriate threshold/s for differential corporate reporting to be, RA&As were asked to indicate whether they consider the presentation and disclosure requirements of the twelve selected statements of SA GAAP listed in table 5-2 to be appropriate for each of the twelve corporate entities listed in table 5-1. The question was repeated in respect of the recognition and measurement requirements of each of the selected twelve statements of SA GAAP. Respondents were also asked to indicate whether they considered the following to be appropriate for each of the twelve entities listed in table 5-1:

- the requirement of AC 118 to present a cash flow statement;
- the requirement of AC 126 to present related party disclosures; and
- the requirement of AC 132 to prepare consolidated financial statements.

Chi-square tests for significant differences between each of the twelve entity types were performed, that is, sixty-six entity type pair-wise comparisons, to identify significant differences, if any, in the responses to each of the twenty-seven applicability scores, that is, twelve presentation and disclosure plus twelve recognition and measurement plus three whole standards of SA GAAP. As a basis for overall comparison, these results are further analysed as follows: i) a frequency table, with a maximum of twenty-seven chi-square scores for each of the sixty-six entity type pair-wise comparisons that are significant at the ninety-five percent confidence level and ii) the arithmetic mean of the twenty-seven chi-square values for each of the sixty-six entity type pair-wise comparisons. Read together, these tables should provide a clear indication of RA&As' perceptions of the appropriate threshold/s for differential corporate reporting in South Africa.

The results of this aspect of this research are important as consideration of the perceived applicability of SA GAAP to the twelve entity types tested may assist the South African authorities and standard-setters in establishing the South African differential corporate reporting threshold/s.

5.5.2.5 Content

In view of the fact that differential reporting requirements vary widely from country to country (refer to chapter 4), and as the South African authorities and standard-setters are currently exploring differential corporate reporting options (refer to chapters 3 and 4), South African RA&As' views of the suitability of selected statements of SA GAAP (see table 5-2 above) to twelve hypothetical corporate entity types (see table 5-1 above) were analysed.

The data collected in respect of the questions set out in 5.5.2.4 above was statistically analysed to give an indication of what RA&As perceive aspects of the appropriate content of South African differential corporate reporting to be. Chi-square tests for significant differences between each of the twelve entity types were performed, that is, sixty-six entity type pair-wise comparisons, to identify significant differences in the responses to each of the twenty-seven applicability scores, that is, twelve presentation and disclosure plus twelve recognition and measurement plus three entire standards of SA GAAP. The results of this aspect of the research are important as consideration of the significance of the individual chi-square values may assist South African authorities and standard-setters in establishing the extent to which differential corporate reporting requirements in respect of certain statements of GAAP are perceived to be desirable.

In view of the fact that differential reporting 'concessions' in respect of recognition and measurement issues remains contentious while there is significantly higher acceptance in respect of presentation and disclosure concessions, for example, IASB (2003), IASCF (2004) and SAICA (2002d, 2004d), South African RA&As' perceptions of the suitability of the presentation and disclosure and the suitability of the recognition and measurement requirements of twelve selected statements of SA GAAP (see table 5-2 above) to twelve hypothetical corporate entity types (see table 5-1 above) were separately analysed. Chi-square tests were performed at the ninety-five percent level of confidence for significant differences between the presentation and disclosure and the recognition and measurement responses for each of the twelve statements of SA GAAP and for each of the twelve entity types. Accordingly, a total of one hundred and forty-four two-by-two pair-wise comparisons, that is, twelve entity types by twelve statements of SA GAAP were performed. The results of this aspect of this research are important as it may assist the South African authorities and standard-setters in establishing the extent to which, if at all, recognition and measurement concessions should be included in South African differential corporate reporting requirements.

5.5.3 Covering letters

Each questionnaire was mailed with an appropriate covering letter from the researcher on a University of Natal (now the University of KwaZulu-Natal) letterhead. The covering letter (included in appendix A) was designed to assist in eliciting a prompt and carefully considered response from the respondents. The covering letter emphasised:

- the importance of the research to the researcher, the accountancy profession and the respondents,
- the matter being researched,
- the potential impact of the research on the respondents,
- the reasons why RA&As were selected as the population for the study,
- the expected time-frame required to complete the questionnaire,
- the importance of completion and the deadline for return of the questionnaire,
- the contact details of the researcher should the respondents have any queries, and
- the inclusion of a return-addressed postage-paid envelope.

Although anonymity was not promised, respondents were not requested to record personal details of a type that could lead to their individual identification. Questionnaires were however

prominently numbered so as to facilitate the follow-up of non-respondents and this may have led respondents to believe that their responses were not anonymous. However, this is unlikely to have materially affected the response rate as experimental evidence has shown that promise of anonymity, either explicit or implied, has no significant effect on response rates (Cooper & Schindler,2001:315).

5.5.4 Pretesting

After designing the questionnaire in a form suitable for distribution to the respondents, the questionnaire was repeatedly pretested before being distributed to the respondents. Pretesting was undertaken to: (Cooper & Schindler,2001:359-360):

1. ensure respondent interest, because it is likely to affect the response rate;
2. ensure that the language used is unambiguous, relevant and understandable;
3. minimise the risk of question transformation, that is, that respondents do not modify the question to fit their own frame of reference;
4. ensure the continuity and flow of the questionnaire;
5. ensure appropriate question sequence;
6. ensure that the questionnaire is not unduly lengthy.

Initially, researcher pretesting was undertaken by five colleagues in the School of Accounting and Finance at the University of Natal. This resulted in four new drafts of the questionnaire being prepared before undertaking respondent pretesting. The amendments arising from researcher pretesting included improvements to understandability, continuity and flow and length. The most significant adjustment made was the merging of questions in respect of the applicability of the recognition and the measurement elements of the twelve statements of SA GAAP into a single category, namely, recognition and measurement. This amendment was made for two reasons: i) most of the pretesters experienced difficulty in distinguishing recognition from measurement, and ii) because before this amendment they found completion of the questionnaire to be too time consuming.

Collaborate respondent pretesting was thereafter undertaken by two chartered accountants in public practice. No significant changes arose from respondent pretesting.

5.5.5 Distribution of questionnaires

The postal addresses of the RA&As were obtained from the PAAB's list of RA&As at 31 March 2002. The first batch of questionnaires was mailed during November 2002. The questionnaire was mailed under a covering letter and a postage paid envelope was included.

In January 2003, a second mailing was undertaken to improve the response rate. The second mailing included a revised covering letter designed to appeal to the addressee's professional duty to respond. Chi-square tests for significant differences between respondents to the first and second mailing revealed no significant difference at the ninety-five percent level of confidence. Further, this indicates that the quality of the responses to the second mailing is not significantly different to those of the first mailing.

5.6 Response rate

An overall response rate of eighteen percent was attained, twelve percent of which is in respect of the first mailing with the balance of six percent in respect of the second mailing (refer to table 5-3 below). The lower than expected response rate is attributed, in part, to the length of the questionnaire.

Table 5-3 Response rate

Mailing	Number	% of sample of 353
First	43	12
Second	21	6
	64	18

5.7 Data preparation, processing and analysis

To prepare the data for analysis, it was captured in a statistical package (SPSS). No returned questionnaires were discarded. The captured data was checked for accuracy by calling the data from the completed questionnaires to a printout of the coded SPSS database.

The reliability of the instrument was measured using the alpha coefficient. The alpha coefficient across all subjects was 0.9876 indicating that the treatment variables captured the desired construct independence.

Data summaries were then outputted from SPSS. The data was analysed by SPSS, that is, cross-tabulated, according to each of the demographic variables of experience and practice size. The results of the cross-tabulations are summarised and discussed in chapter 6.

The data summaries obtained from SPSS were used as the inputs for chi-square tests for significant differences that were performed on an excel spreadsheet. SPSS was not used to compute the chi-square values, as the researcher was more familiar with spreadsheet technology. So as to minimise the risk of programming errors, the spreadsheets were designed systematically. Haphazardly selected chi-square values were manually recomputed and all chi-square values were reviewed for reasonableness in light of the inputs obtained from SPSS. The results of the chi-square tests are summarised and discussed in chapter 6.

Chi-square testing was chosen because it is especially valuable for nominal data and is probably the most widely used nonparametric test of significance. Chi-square is used to test for significant differences between the observed distribution of data among categories and the expected distribution based on the null hypothesis (Cooper & Schindler,2001:499).

The formulae by which chi-square is calculated is:

$$X^2 = \sum_i \sum_j \frac{(Oij - Eij)^2}{Eij}$$

In which

Oij = the observed number of cases categorised in the ijth cell

Eij = the expected number of cases under H_0 to be categorised in the ijth cell (503).

There is a different distribution of X^2 for each number of degrees of freedom. Degrees of freedom are defined as rows minus one multiplied by columns minus one. The critical value for X^2 is dependent upon the degrees of freedom and the significance level and can be secured from a table of critical values. The null hypothesis is rejected where the calculated value, that is, X^2, exceeds the critical value (500-501).

Chi-square tests are only valid where the data comes from random samples. Expected frequencies below five should not compose more than twenty percent of the cells and no cell should have an expected frequency of less than one. Cooper and Schindler (505) reflect that some research has argued that the last two restrictions are too severe.

5.8 Limitations of the research

The choice of RA&As as the population is a limitation in the research design. RA&As are not primary users of financial statements therefore their perceptions of primary users' views may not be accurate.

Postal opinion research is a limitation in the research design as the responses are the opinions of the respondents are subjective. Bias may result from respondents returning the questionnaires representing the extremes of the population (Cooper & Schindler,2001:313). The low response rate is also a limiting factor.

5.9 Summary

This chapter explained the research methodology used to confirm the need for differential corporate reporting and to provide some insights of the desired form, content and applicability of South African differential reporting requirements.

An exploratory study was undertaken to determine the attitudes of RA&As to differential reporting as i) the enactment of South African differential reporting requirements is imminent; ii) there is very little South African differential corporate reporting research; and iii) there is widespread dissatisfaction with existing disparate global differential reporting requirements. RA&As, who were chosen for their knowledge of SA GAAP and their understanding of SA GAAP and the financial statement user's needs, were surveyed by means of a postal questionnaire.

The data collection and analysis were discussed from the design of the postal questionnaire to the preparation and statistical analysis of the data collected. A description of the statistics used was also furnished.

In the next chapter the findings of the research are discussed and evaluated.

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Chapter 6

RESEARCH FINDINGS

6.1 Introduction

The previous chapter described the research methodology used to confirm the need for differential corporate reporting and to provide some insights of: (i) the perceived threshold/s for differential reporting, (ii) the form that differential reporting may take, and (iii) the desired content of South African differential reporting. The research findings resulting from the application of the research methodology are presented and analysed in this chapter. Separate sections of this chapter are devoted to findings in respect of each of the four research questions investigated. First, the perceived need for differential corporate reporting, then the suitability of different forms that differential corporate reporting may take, followed by the entities to which differential corporate reporting should be applicable, and fourth some indications of what the detailed requirements of differential corporate reporting should be.

6.2 Respondent demography

Due to the length of the questionnaire, only two items of demographic information were requested, namely, practice size and level of experience. The purpose of collecting the demographic information was to provide more information about the respondents and to facilitate the analysis and interpretation of their attitudes to differential corporate reporting.

6.2.1 Practice size demographic

The size of the respondent's practice was collected so as to determine if a relationship exists between the size of South African registered accountants and auditors' (RA&As) practices and their attitudes towards some of the issues tested in the questionnaire.

The client bases of the largest practices generally comprise large securities exchange listed public companies. The client bases of the smallest practices generally comprise small owner-managed businesses. The effects of differential corporate reporting therefore are likely to be most significant for smaller practices.

Table 6-1 shows how the respondents are skewed towards smaller practices necessitating the collapse of the three largest categories of the practice size demographic into a single category (large) for the purposes of analysis. This result is not unexpected and is probably indicative of the spread of the practice size demographic within the population. As two respondents did not indicate the size of their practices, the total number of usable questionnaires for analysis by practice size was limited to sixty-two.

Table 6-1 Practice size demographic

	Count	%
Large multinational	12	19%
Large (Multiple JSE listed clients)	4	7%
Medium	12	19%
Large	28	45%
Small	34	55%
Total	62	100%

As the division between the category, medium, and therefore the combined category, large, and the category, small, is not clearly defined and the number of respondents in each of the categories is low, the results of the analysis by practice size demographic must be interpreted with caution.

6.2.2 Experience demographic

The number of years that a respondent has been registered as a RA&A, that is, the experience demographic, was collected to determine if a relationship exists between the level of RA&As' experience and their attitudes towards some of the issues tested in the questionnaire.

The level of the respondents' experience was measured in four categories with reference to the number of years that the respondents have been registered with the Public Accountants' and Auditors' Board (PAAB). This measure is considered appropriate as it is applicable to all respondents and represents the time period over which the respondent has legally been in a position to sign the audit report of South African companies. Further, as all South African companies are required to report in accordance with South African statements of generally accepted accounting practice (SA GAAP), it can reasonably be assumed that RA&As are knowledgeable of SA GAAP.

Table 6-2 shows how the respondents are skewed towards the more experienced categories necessitating the collapse of the three smaller categories into a single category for analysis.

Table 6-2 Experience demographic

	Respondents	
	Count	%
Less than 5 years	5	8
5 to 10 years	14	22
11 to 20 years	20	31
20 years or less	39	61
More than 20 years	25	39
Total	64	100

The result is not unexpected and is probably indicative of the spread of the experience demographic within the population. As the number of respondents in each of the categories is low, the results of the analysis by experience demographic must be interpreted with caution.

6.3 Desirability

Respondents were first asked whether they perceived a need for differential corporate reporting requirements in South Africa. Ninety-seven percent of the respondents answered yes, one respondent answered no, and one respondent omitted to answer this question. Respondents were also asked to briefly support their answer.

Respondents who perceived a need for differential reporting, most commonly cited the following reasons in support of differential corporate reporting: (i) SA GAAP is irrelevant/inappropriate to small/owner-managed businesses (ii) The cost to small/owner-managed businesses of complying with SA GAAP exceeds the benefits (including, "it is economically impractical to comply with SA GAAP" and "resistance to fees incurred by accountants in achieving SA GAAP compliance"), and (iii) SA GAAP is too complex/onerous for small/owner-managed businesses. The extent to which these reasons were cited is set out in table 6-3. Other relevant reasons cited in support of differential corporate reporting included: (i) certain statements, for example SAICA (1999f), that is, AC 130, are in direct opposition to entities determining their real profit, (ii) tax GAAP is appropriate as annual financial statements are prepared for South African Revenue Services, (iii) recording imported inventory at the forward rate is meaningful, (iv) GAAP is designed for general purpose financial statements

and/or GAAP is designed to protect the public interest and is therefore not applicable to small owner-managed businesses.

Three affirmative respondents, that is, five percent of the affirmative respondents, gave no supporting reasons.

Seemingly irrelevant reasons provided by some affirmative respondents in support of differential corporate reporting were: (i) formalised deviations from GAAP for private companies and close corporations, (ii) owner managed businesses do not always require a full audit function.

The respondent who did not perceive a need for differential corporate reporting in South Africa stated that differential reporting could be useful but is not really necessary. This respondent has more than twenty years experience in a small practice.

Table 6-3 Reasons for differential reporting for small/owner-managed corporate entities

	Costs > Benefits	**Irrelevant and/or inappropriate**	**Complex and/or onerous**
Number of respondents that cited this reason	**31**	**42**	21
Total number of affirmative respondents	**62**	**62**	62
Percentage cited	50%	68%	34%

The respondent that omitted to answer this question reported that all statements tested for are appropriate to all entity forms. The response suggests that the respondent does not perceive a need for differential corporate reporting in South Africa. This respondent has more than twenty years experience in a large multinational practice.

Overall, the responses indicate a strongly perceived need for differential corporate reporting in South Africa. This is consistent with international trends in differential reporting and a recent prior South African study (Hattingh,2002b) reported on in chapter 4. The next sections report the findings of this study into the form, content and threshold/s for differential corporate reporting, all of which are considerably more complex than the increasingly acknowledged need for differential corporate reporting that was confirmed in this section.

6.4 Form

This section of the research sought to determine which form/s of differential corporate reporting RA&As perceive to be appropriate in the South African context.

To establish if perceptions of the appropriateness of different possible forms of differential corporate reporting are dependent upon the size of the reporting entity's financial statement user base, questions were posed separately in respect of an entity with a narrow user base and an entity with a wide user base. Consistent with current draft South African legislation, and also to limit the length of the questionnaire, questions regarding the form that differential corporate reporting should take were limited to private companies.

Using a five-point Likert scale, respondents were asked to rate the suitability, ranging from very unsuitable to very suitable, of each of the following possible forms of differential reporting for the limited purpose financial statements of a private company whose financial statements are only distributed to its shareholders and attached to its IT14 tax return, that is a narrow financial statement user base:

a) The income tax basis, that is, in accordance with tax law.
b) The cash basis, that is, record cash transactions only.
c) Unlimited deviations from SA GAAP, that is, the private company devises its own accounting policies without reference to SA GAAP.
d) Limited formalised deviations from SA GAAP, that is, each SA statement of GAAP specifies exemptions from specific provisions.
e) Completely separate set of SA GAAP for limited purpose financial statements.

Where the user base of the private company was extended to include its bankers and other financiers, its franchisor, government agencies, etc, that is, a wide user base, support for the income tax basis declined from a mean of 3,4 (see table 6-4) to a mean of 3,0 (see table 6-5). Conversely, support for limited formalised deviations from SA GAAP and for a completely separate set of GAAP for limited purpose financial statements, increased marginally where the user base was expanded.

The results presented in table 6-4 and table 6-5 indicate little support for the cash basis and unlimited deviations from SA GAAP. Significant support is indicated for limited formalised deviations from SA GAAP, a completely separate set of SA GAAP for limited purpose financial

statements and the income tax basis. These results show some support for the proposal of ED 163 and the preliminary views of the IASB that differential corporate reporting effectively be based on limited formalised deviations from GAAP. However, there are indications that a separate set of SA GAAP for small and medium-sized entities (SMEs) also enjoys significant support particularly as that form was most frequently rated, very suitable, irrespective of the financial statement user base.

Table 6-4 Suitability for narrow user base

	Very unsuitable 1	Unsuitable 2	Indifferent 3	Suitable 4	Very suitable 5	Mean	Rank -ing
Cash basis	26	21	6	6	5	2,1	5
Unlimited deviations from SA GAAP	25	22	5	6	6	2,2	4
Income tax basis	8	13	2	26	14	3,4	3
Limited deviations from SA GAAP	4	7	7	31	15	3,7	1
Completely separate set of SA GAAP	12	6	8	14	23	3,5	2

Table 6-5 Suitability for wide user base

	Very unsuitable 1	Unsuitable 2	Indifferent 3	Suitable 4	Very suitable 5	Mean	Rank -ing
Cash basis	26	23	5	6	4	2,0	5
Unlimited deviations from SA GAAP	27	21	4	7	5	2,1	4
Income tax basis	11	17	2	24	9	3,0	3
Limited deviations from SA GAAP	3	4	9	32	15	3,8	1
Completely separate set of SA GAAP	10	7	6	18	23	3,6	2

The results of the cross-tabulation of the practice size demographic with the suitability ratings of different forms that South African differential corporate reporting may take for a private company with: i) a narrow user base are presented in table 6-6, and ii) a wide user base are presented in table 6-7. Consistent with the overall result, both categories of practice size found the cash basis and unlimited deviations from SA GAAP unsuitable irrespective of the user base.

Table 6-6 Suitability for narrow user base by practice size

	Very unsuitable	Unsuitable	Indifferent	Suitable	Very suitable	Mean	Rank -ing
	1	**2**	**3**	**4**	**5**		
Cash basis	**25**	**20**	**6**	**6**	**5**	**2,1**	5
- large	13	8	2	4	1	2,0	5
- small	**12**	**12**	**4**	**2**	**4**	2,3	5
Unlimited deviations from SA GAAP	**23**	**22**	**5**	**6**	**6**	2,2	4
- large	10	10	4	2	2	2,1	4
- small	13	12	1	4	4	2,3	4
Income tax basis	8	13	2	24	14	3,4	3
- large	5	6	1	9	7	3,3	2
- small	3	7	1	15	7	3,5	3
Limited deviations from SA GAAP	4	7	7	31	13	3,7	1
- large	1	3	3	12	9	3,9	1
- small	3	4	4	19	4	3,6	2
Completely separate set of SA GAAP	11	6	8	14	22	3,5	2
- large	6	4	5	6	7	3,1	3
- small	5	2	3	8	15	3,8	1

Note: Two respondents did not indicate their practice size

The rankings presented in table 6-6 and table 6-7 indicate that RA&As from small practices, irrespective of the width of the financial statement user base, consider a completely separate set of GAAP to be the most suitable form of differential corporate reporting. Limited deviations from SA GAAP was ranked the second most suitable form and the income tax basis was ranked third.

The rankings presented in table 6-6 and table 6-7 indicate that RA&As from large practices consider limited deviations from SA GAAP to be the most suitable differential reporting option irrespective of the width of the financial statement user base. They also rate a completely separate set of GAAP to be suitable irrespective of the width of the user base, but rank the income tax basis the second most suitable form where the user base is narrow. However, they consider the income tax basis to be unsuitable where the user base is wide.

Table 6-7 Suitability for wide user base by practice size

	Very unsuitable 1	Unsuitable 2	Indifferent 3	Suitable 4	Very suitable 5	Mean	Rank -ing
Cash basis	25	22	5	6	4	2,0	5
- large	14	10	1	2	1	1,8	5
- small	11	12	4	4	3	2,4	4
Unlimited deviations from SA GAAP	25	21	4	7	5	2,1	4
- large	10	10	3	3	2	2,2	4
- small	15	11	1	4	3	2,2	5
Income tax basis	11	16	2	23	9	3,0	3
- large	7	9	0	7	5	2,8	3
- small	4	7	2	16	4	3,3	3
Limited deviations from SA GAAP	3	4	9	31	14	3,8	1
- large	0	3	4	11	10	4,0	1
- small	3	1	5	20	4	3,6	2
Completely separate set of SA GAAP	10	7	6	17	22	3,6	2
- large	5	5	4	6	8	3,3	2
- small	5	2	2	11	14	3,9	1

Note: Two respondents did not indicate their practice size

Where the owner-managers and revenue services are the only users of a private company's financial statements, that is, a narrow user base, respondents from both large and small practices find the tax basis of differential corporate reporting appropriate (see table 6-6).

The suitability ratings of RA&A's in large practices appear to be influenced by the width of the financial statement user base, for example, the mean for the income tax basis is 3,3 where the user base is narrow (table 6-6) and 2,8 where the user base is wide (table 6-7).

Possible reasons for the differences between the suitability rankings of respondents in large practices compared with those in small practices could relate to differences in the information needs of their clients. Clients of small practices are likely to be smaller owner-managed private companies who may want financial statements that fulfil the needs of management rather than

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the objectives of general purpose financial statements. A completely separate set of SA GAAP designed to satisfy owner-manager needs would thus obviate the need for dual record keeping and thus save time and money. Clients of large practices are likely to be securities exchange listed companies whose use of private company financial statements would be made easier if they were prepared on the same basis as their own financial statements, for example, for when evaluating the acquisition of a private company. Clients of large practices could therefore incur additional costs in converting the target private company's financial statements prepared under a differential corporate reporting option into a SA GAAP compliant form. It therefore is rational that, based on their clients needs, respondents from large practices rate limited deviations from SA GAAP to be the most suitable form of differential reporting while their counterparts from small firms would, in accordance with the needs of their clients, rate a completely separate set of SA GAAP to be most suitable.

If respondents in large practices generally presented the views of larger private company financial statement users and respondents in small practices generally presented the views of small private company financial statement users, then another possible reason for the differences in their responses could be that a second differential reporting threshold may be appropriate in the South African context. This lowest tier, based on the perceptions of respondents in small practices, could apply to South Africa's smallest corporate entities that are most acutely affected by cost-benefit considerations. A precedent for this lowest tier of differential reporting was discussed in chapter 4, where three tiers of reporting requirements were found to exist for New Zealand companies, with very small New Zealand companies having very limited reporting requirements (ICANZ,2002:para4.7).The multi-tiered approach certainly enjoys the support of the South African Department of Trade and Industry (DTI,2004) who have requested the SAICA to research the threshold for and reporting requirements of possible tiers of companies each with their own reporting requirements (SAICA,2004d).

The results of the cross-tabulation of the experience demographic with the suitability ratings of different forms that South African differential corporate reporting may take for a private company with: i) a narrow user base are presented in table 6-8 below and ii) a wide user base are presented in table 6-9. Consistent with the overall result, both categories of the experience demographic find the cash basis and unlimited deviations from SA GAAP unsuitable irrespective of the width of the financial statement user base.

The rankings presented in table 6-8 and table 6-9 indicate that RA&As with more than twenty years experience, irrespective of the width of the financial statement user base, consider a completely separate set of GAAP to be the most suitable form of differential corporate

reporting, followed by limited deviations from SA GAAP (ranked second) and the income tax basis (ranked third).

Table 6-8 Suitability for narrow user base by level of experience

	Very unsuitable	Unsuitable	Indifferent	Suitable	Very suitable	Mean	Rank -ing
	1	2	3	4	5		
Cash basis	26	21	6	6	5	2,1	5
- 20 years or less	13	14	5	5	2	2,2	4
- more than 20 years	13	7	1	1	3	1,9	5
Unlimited deviations from SA GAAP	25	22	5	6	6	2,2	4
- 20 years or less	19	15	1	2	2	1,8	5
- more than 20 years	6	7	4	4	4	2,7	4
Income tax basis	8	13	2	26	14	3,4	3
- 20 years or less	3	9	1	19	6	3,3	2
- more than 20 years	5	4	1	7	8	3,4	3
Limited deviations from SA GAAP	4	7	7	31	15	3,7	1
- 20 years or less	3	4	3	21	8	3,7	1
- more than 20 years	1	3	4	10	7	3,8	2
Completely separate set of SA GAAP	12	6	8	14	23	3,5	2
- 20 years or less	11	6	4	7	10	2,9	3
- more than 20 years	1	0	4	7	13	4,2	1

The rankings presented in table 6-8 and table 6-9 indicate that RA&As with twenty years or less experience consider limited deviations from SA GAAP to be the most suitable differential reporting option irrespective of user base. However, their second most suitable differential corporate reporting solution ratings are dependent upon the width of the financial statement user base. Where the financial statement user base is wide (see table 6-9), a completely separate set of GAAP is rated second. But, where the financial statement user base is narrow (see table 6-8), the income tax basis is rated second.

The suitability ratings of RA&As with twenty years or less experience appear to be influenced by the width of the financial statement user base. For example, the mean for the income tax

basis is 1,8 where the user base is narrow (see table 6-8) and 1,7 where the user base is wide (see table 6-9).

Table 6-9 Suitability for wide user base by level of experience

	Very unsuitable	Unsuitable	Indifferent	Suitable	Very suitable	Mean	Rank -ing
	1	2	3	4	5		
Cash basis	**26**	**23**	**5**	**6**	**4**	**2,0**	5
- 20 years or less	14	17	3	3	2	2,0	4
- more than 20 years	12	6	2	3	2	2,0	5
Unlimited deviations from SA GAAP	27	21	4	7	5	2,1	4
- 20 years or less	22	13	1	1	2	1,7	5
- more than 20 years	5	8	3	6	3	2,8	4
Income tax basis	**11**	**17**	**2**	**24**	**9**	**3,0**	3
- 20 years or less	5	12	1	17	3	3,0	3
- more than 20 years	6	5	1	7	6	3,0	3
Limited deviations from SA GAAP	3	4	9	32	15	3,8	1
- 20 years or less	1	3	5	21	8	3,8	1
- more than 20 years	2	1	4	11	7	3,8	2
Completely separate set of SA GAAP	10	7	6	18	23	3,6	2
- 20 years or less	9	7	2	10	11	3,2	2
- more than 20 years	1	0	4	8	12	4,2	1

Possible reasons for the differences between the suitability rankings of respondents with more experience compared to those with less experience, are elusive and should form the subject of future research.

This section established that overall RA&As perceive limited deviations from SA GAAP to be the most appropriate form that South African differential corporate reporting may take. However, it was also established that this view is not shared by significant subpopulations of RA&As who perceive a completely separate set of SA GAAP to be the most appropriate form.

In the next section, the results of tests designed to establish RA&As' perceptions of what factors should be applied in determining the differential corporate reporting threshold are presented.

6.5 Threshold

The primary questions were in respect of twelve hypothetical corporate entities varied by size, legal structure and user base, as set out in table 5-1. Respondents were given a listing of twelve statements of SA GAAP, as set out in table 5-2, and were asked to indicate whether they consider the presentation and disclosure requirements of each statement of SA GAAP to be appropriate for each of the twelve hypothetical corporate entities listed in table 5-1. The question was repeated in respect of the recognition and measurement requirements of each of the twelve statements of SA GAAP. Respondents were also asked to indicate whether they considered the following to be appropriate for each of the twelve hypothetical corporate entities listed in table 5-1:

- the requirement of SAICA (1996), that is, AC 118, to present a cash flow statement;
- the requirement of SAICA (2000d), that is, AC 126, to present related party disclosures; and
- the requirement of SAICA (1999g), that is, AC 132, to prepare consolidated financial statements.

All statements of SA GAAP were not included in the questionnaire, as this would have made completion of the questionnaire too onerous. As differential corporate reporting is effectively in existence in respect of those statements of SA GAAP with which unlisted entities are not required to comply, all such statements of SA GAAP were excluded. With the exception of SAICA (2001d), that is, AC 137, statements of SA GAAP that are industry specific were also excluded. AC 137 was included as agriculture is an important and widely distributed industry in South Africa. Consequently, the author believed that most RA&As would have clients that are subject to AC 137.

The results that follow are in respect of the questions that required respondents to indicate for each of the twelve entity types the applicability of the requirements of the fifteen selected statements of SA GAAP (detailed in table 5-2). Separate evaluation in respect of the presentation and disclosure requirements and the recognition and measurement requirements of twelve of the fifteen statements was required. The results of these questions are presented in table 6-10.

Table 6-10 Percentage that responded appropriate

	A	B	C	D	E	F	G	H	I	J	K	L
	B JSE %	S JSE %	B PUB %	S PUB %	B Pvt N %	B Pvt Usrs %	S Pvt N %	S Pvt Usrs %	B cc N %	B cc Usrs %	S cc N %	S cc Usrs %
P&D												
102	100	100	98	94	64	81	34	55	45	63	25	39
105	98	98	95	94	64	86	42	59	48	61	38	44
108	98	98	98	98	83	89	59	72	56	70	41	53
112	95	95	91	89	56	75	27	39	38	47	22	27
116	95	92	89	81	25	55	9	27	16	38	8	17
123	97	98	97	97	77	86	63	73	59	69	50	56
125	95	92	88	78	33	58	14	23	22	38	11	19
128	95	92	92	84	48	72	28	42	31	50	25	33
129	97	97	95	91	56	77	33	48	31	52	27	34
130	98	97	97	94	67	77	44	56	52	58	34	41
135	97	95	92	89	59	72	25	41	33	52	16	23
137	80	78	78	70	42	56	16	27	25	36	14	19
R&M												
102	98	97	97	89	69	81	44	58	50	63	39	42
105	98	98	97	92	66	84	45	56	47	56	38	41
108	98	98	98	97	80	91	63	73	58	73	50	55
112	95	95	92	86	53	75	30	42	34	45	25	30
116	97	95	92	81	31	61	11	27	22	38	11	19
123	98	98	97	95	77	84	56	69	55	67	47	55
133	95	92	91	83	42	61	13	25	23	38	11	17
128	97	94	94	88	56	73	30	44	34	53	27	36
129	95	95	95	88	56	77	31	42	36	52	30	36
130	98	97	95	91	64	77	45	53	48	61	41	44
135	97	95	94	91	56	70	27	41	34	53	20	28
137	81	78	78	75	38	56	17	27	25	39	16	19
Other												
118	91	89	88	84	58	73	28	52	42	61	23	44
126	92	91	86	80	41	63	16	47	28	50	14	31
132	94	94	83	80	44	73	20	53	17	45	11	28
Mean	**95**	**94**	**92**	**87**	**56**	**73**	**32**	**47**	**37**	**53**	**26**	**34**
Rank	1	2	3	4	6	5	11	8	9	7	12	10

P&D = Presentation and disclosure

R&M = Recognition and measurement

Using the observations from which table 6-10 was constructed, twenty-seven chi-square values were computed for each of the sixty-six entity type comparisons. Table 6-11 presents the level of significance at which there is a statistically significant difference between the mean values of the responses in respect of the twenty-seven chi-square values computed for each of the sixty-six entity type comparisons. Levels of confidence less than ninety-five percent were discarded.

Table 6-11 Mean chi-square values

	A	B	C	D	E	F	G	H	I	J	K	L
	B JSE	S JSE	B PUB	S PUB	B Pvt N	B Pvt Usrs	S Pvt N	S Pvt Usrs	B cc N	B cc Usrs	S cc N	S cc Usrs
A		-	-	-	**** 28,96	**** 12,51	**** 58,06	**** 38,39	**** 49,94	**** 31,34	**** 66,20	**** 53,96
B			-	-	**** 26,96	**** 10,94	**** 55,67	**** 36,21	**** 47,67	**** 29,34	**** 63,78	**** 51,65
C				-	**** 23,62	*** 8,61	**** 51,62	**** 32,74	**** 43,76	**** 25,98	**** 59,60	**** 47,72
D					**** 16,96	* 4,42	**** 43,00	**** 25,27	**** 35,61	**** 19,20	**** 50,73	**** 39,37
E						* 5,05	*** 8,21	1,62	* 4,92	0,67	**** 12,74	*** 6,80
F							**** 23,81	*** 10,28	**** 18,08	** 6,47	**** 30,28	**** 20,93
G								3,79	0,95	*** 6,84	0,78	0,64
H									2,00	0,91	*** 7,05	2,53
I										3,58	2,28	0,50
J											*** 10,56	* 4,85
K												1,46

* 5% level of significance; d.f. = 1.

** 2% level of significance; d.f. = 1.

*** 1% level of significance; d.f. = 1.

**** 0,01% level of significance; d.f. = 1.

\- Insufficient differences existed for valid chi-square tests to be performed as one or more expected value is less than five (Cooper & Schindler,2001:500).

Table 6-12 presents the frequency with which significant differences were found in respect of the twenty-seven chi-square tests for significant differences computed for each of the sixty-six entity type comparisons.

Table 6-12 Frequency at 95% confidence level

	A	B	C	D	E	F	G	H	I	J	K	L
						B Pvt		S Pvt		B cc		S cc
	B JSE	S JSE	B PUB	S PUB	B Pvt N	Usrs	S Pvt N	Usrs	B cc N	Usrs	S cc N	Usrs
A		-	-	-	27	26	27	27	27	27	27	27
B			-	-	27	26	27	27	27	27	27	27
C				-	27	24	27	27	27	27	27	27
D					27	17	27	27	27	27	27	27
E						16	26	2	18	0	27	20
F							**27**	**25**	**27**	**22**	27	27
G								**6**	**0**	**19**	**1**	1
H									**3**	**0**	**22**	5
I										**9**	**4**	0
J											**27**	17
K												3

\- Insufficient differences existed for valid chi-square tests to be performed as one or more expected value is less than five (Cooper & Schindler,2001:500).

Note: Twenty-seven (27) is the maximum possible frequency; d.f. = 1.

The results of many of the chi-square tests for significant differences between entities A to D were invalid as the expected frequencies in respect of the inappropriate cells were frequently less than five. In respect of SAICA (1995), that is, AC 108, only, did the invalid tests extend to another entity, that is, entity F, and then only in respect of comparisons with entities A to D. In the case of entity F, in order to maintain the equality of the entity comparisons, the invalid chi-square values were not discarded. This may have marginally impacted upon the results. However, that effect is unlikely to be material as some researchers have argued that the requirement that the expected frequencies be less than five is too severe (Cooper & Schindler,2001:505).

The responses in respect of SAICA (2001d), that is, AC 137, may be biased toward the negative for all entities presented, as AC 137 is operative only for annual financial statements covering periods beginning on or after 1 January 2003 (para59). Consequently, at the time of responding, some respondents' knowledge of AC 137 may have been limited.

The aggregate responses presented in table 6-10 indicate high overall acceptance of SA GAAP for securities exchange listed entities, that is, entities A and B, and public companies, that is, entities C and D. The degree of acceptability is lower in respect of big private companies, that is, entities E and F, and big close corporations with users, that is, entity J. In respect of all other entities, that is, entities G, H, I, K and L, there are indications that SA GAAP is not considered to be appropriate.

An inspection of the summary of responses presented in table 6-10 suggests that there is unlikely to be any globally significant difference between responses in respect of entities A to D. This is corroborated by the results presented in table 6-11 and table 6-12 that show highly significant differences between entities A to D and all other entities presented, that is, entities E to L. With the exception of differences between big private company with users, that is, entity F and both public companies, that is, entities C and D, these differences were all significant at the ninety-nine comma nine percent level of confidence. The results presented in table 6-12 find that in respect of each of the twenty-seven chi-square tests for significant differences conducted at the ninety-five percent level of confidence, significant differences were found between entities A to D and all other entities, except entity F. Only the tests for significant differences between entity F and each of entities A and B in respect of the presentation and disclosure requirements of SAICA (1995), that is, AC 108, did not record significant differences. The limitations set out above in respect of AC 108 may be relevant to this result. These results indicates some support for differential reporting requirements for all private companies irrespective of their size and the width of their financial statement user base.

As no statistically significant difference was found between entities A to D and as the threshold proposed by SAICA (2003a), that is, ED 163, lies outside of this range, these entities are excluded from further analysis in respect of differential reporting thresholds.

The aggregate responses presented in table 6-11 indicate that RA&As perceive more of SA GAAP to be appropriate to big private companies with users (entity F) than for the remainder of the entities tested (entities E and G to L). At the ninety-five percent level of confidence, the results presented in table 6-12 find big private companies with users (entity F)

differentiated from all other entities. Further, the results presented in table 6-12 find significant differences at the ninety-five percent level of confidence between entity F and all other entities in respect of the majority of the twenty-seven chi-square tests. These results suggest that it may be appropriate for big private companies with users to have unique reporting requirements.

The aggregate responses in table 6-11 suggest that no single factor is perceived by RA&As to be paramount to the determination of differential corporate reporting thresholds and that a matrix of entity size, entity form and financial statement user base are collectively significant in a common direction.

The summary of responses presented in table 6-11 suggest that the majority of RA&As on average find SA GAAP appropriate for all big entities. However, the level of acceptability is lower where bigger entities have a narrow financial statement user base or a less regulated entity form. The results presented in table 6-12 indicate that RA&As consider entity size to be the most important factor with mean chi-square values at the ninety-nine percent level of confidence being recorded in respect of private companies, that is, big versus small, irrespective of the width of the financial statement user base. Close corporations with a wide financial statement user base, big versus small, were differentiated at the ninety-five percent level of confidence. However, no significant difference was found in respect of close corporations with a narrow financial statement user base, big versus small.

RA&As' responses in respect of entity form are statistically different only at the ninety-eight percent and ninety-five percent confidence levels for big private company versus big close corporation comparisons, with users and without users respectively. No statistically significant differences were found in respect of small private company versus small close corporation comparisons irrespective of the width of their financial statement user base.

The results presented in table 6-11 indicate that RA&As perceive the width of the financial statement user base to be the least significant of the three factors tested. A significant difference was found only in respect of big private companies, that is, with users versus without users, where the difference was significant only at the ninety-five percent level of confidence.

Although this research finds that RA&As perceive entity size to be the most significant factor, all combinations of entity form and financial statement user base that share a common direction, that is, private company to close corporation and with users to no users, except small private company with users versus big close corporation with no users were found to be significantly different at the ninety-five percent level of confidence. This suggests that a single threshold for

differential corporate reporting may not adequately address the South African differential corporate reporting dilemma. Multiple differential corporate reporting thresholds each with its own reporting requirements, may therefore be the most comprehensive solution in the South African context. A precedent for multi-tiered differential reporting that was discussed in chapter 4, can be found in New Zealand. New Zealand companies that do not have public accountability, amongst other requirements, qualify for limited differential reporting options (ICANZ,2002:para4.25), whereas very small New Zealand companies need only comply with very limited reporting requirements (para4.7). Further, this result supports the current multi-tiered company proposals of the South African Department of Trade and Industry (DTI,2004), the thresholds for and reporting requirements of which, are currently being investigated by the SAICA (SAICA,2004d).

6.6 Content

6.6.1 Presentation and disclosure versus recognition and measurement

Respondents were given a listing of twelve statements of SA GAAP, listed in table 5-2, and were asked to indicate whether they consider the presentation and disclosure requirements of each statement of SA GAAP to be appropriate for each of the twelve hypothetical corporate entities listed in table 5-1. The question was repeated in respect of the recognition and measurement requirements of each of the twelve statements of SA GAAP. The summarised responses to these questions are presented in table 6-10.

All statements of SA GAAP that have both presentation and disclosure and recognition and measurement requirements were not included in the questionnaire, as this would have made completion of the questionnaire too onerous. As differential corporate reporting is effectively in existence in respect of those statements of SA GAAP with which unlisted entities are not required to comply, all such statements of SA GAAP were excluded. With the exception of AC 137, statements of SA GAAP that are industry specific were also excluded. AC 137 was included as agriculture is an important and widely distributed industry in South Africa. Consequently, the author believed that most RA&As would have clients that are subject to AC 137.

Using the presentation and disclosure and the recognition and measurement observations from which table 6-10 was constructed, twelve chi-square values were computed for each of the twelve entity types. These chi-square tests were conducted to test for significant differences

between respondents' assessments of the appropriateness of the presentation and disclosure requirements and the recognition and measurement requirements of each of the twelve statements of SA GAAP listed in table 5-2. At the ninety-five percent level of confidence no significant differences were found. This result indicates that RA&As perceive equally the need for differential corporate reporting requirements in respect of both the presentation and disclosure requirements and the recognition and measurement requirements of SA GAAP.

The results of many of the chi-square tests of most statements of SA GAAP tested for in respect of both JSE listed entities and a big public company, that is entities A to C, were invalid as the expected frequencies in respect of the inappropriate cells were frequently less than five. In respect of AC 105, AC 108 and AC 123 only, did the invalid tests extend to another entity, namely, entity D. All invalid chi-square values were discarded. However, a review of the summary of responses presented in table 6-10 in respect of entities A to D shows that both the presentation and disclosure requirements and the recognition and measurement requirements of all of the statements of GAAP tested for are strongly perceived to be appropriate to these entities. This indicates that there is unlikely to be any significant difference between RA&As' perceptions of the appropriateness of the presentation and disclosure requirements and the recognition and measurement requirements of SA GAAP to entities A to D.

This finding supports the principle of granting recognition and measurement concessions which is found in current Canadian (CICA,2002a) and New Zealand (ICANZ,2002) differential reporting requirements and the proposed South African requirements (SAICA,2003a) presented in chapter 4. However, this finding indicates some support for more extensive recognition and measurement concessions. Further, this finding is incongruent with the IASB's rebuttable presumption that no recognition and measurement modifications should be granted to SMEs (IASCF,2004).

6.6.2 Cash flow statement

The aggregate responses presented in table 6-10 found that the majority of the respondents perceive it to be appropriate that all companies, except small private companies with a limited financial statement user base, that is, entity G, be required to present a cash flow statement. Further, the majority of respondents perceived that cash flow statements are not appropriate for close corporations, except big close corporations with a wide user base, that is, entity J.

The results of the chi-square tests performed at the ninety-five percent level of confidence confirm that there are significant differences between responses for entities A to D compared

with responses for all other entities, except that no significant difference was found between the responses for a small public company, that is, entity D, and a big private company with a wide financial statement user base, that is, entity F.

Chi-square tests for significant differences in the range of entity E to L revealed significant differences in respect of: (i) entity size except in respect of close corporations with users, and (ii) user base, except in respect of big private companies. No significant differences were found in respect of the entity form variable.

The results indicate that RA&As perceive the requirement to prepare a cash flow statement appropriate to all public companies, all private companies except small private companies with a narrow user base, and big close corporations that have a wide financial statement user base. This finding supports the current multi-tiered company proposals of the South African Department of Trade and Industry (DTI,2004), the thresholds for and reporting requirements of which, are currently being investigated by the SAICA (SAICA,2004d).

6.6.3 Related party disclosures

The aggregate responses presented in table 6-10 found that the majority of respondents perceive the requirements of SAICA (2000d), that is, AC 126, to be appropriate only to securities exchange listed entities, public companies, big private companies with users and big close corporations with users, that is, entities A to D, F & J.

The results of the chi-square tests performed confirm that at the ninety-five percent level of confidence there are significant differences between responses for entities A to D and all other entities. Further, at the ninety-five percent level of confidence, significant differences were found between entity F and all other entities except entities H & J. The results indicate that RA&As perceive a need for differential corporate reporting requirements in respect of the requirements of AC 126 particularly where there is a limited financial statement user base. This finding is contrary to ED 163 that does not propose any exemptions from the requirements of AC 126. However, this result supports the current multi-tiered company proposals of the South African Department of Trade and Industry (DTI,2004), the thresholds for and reporting requirements of which, are currently being investigated by the SAICA (SAICA,2004d).

6.6.4 Consolidated financial statements

The aggregate responses presented in table 6-10 indicate that the majority of respondents perceive consolidated financial statements not to be appropriate for all close corporations and all private companies with a limited user base.

The results of the chi-square tests performed found that at the ninety-five percent level of confidence, there are significant differences between responses for securities exchange listed companies and all other entities.

Chi-square tests for significant differences, at the ninety-five percent level of confidence, in the range of entity C to entity L find significant differences in respect of: (i) entity size, except in respect of public companies, for which respondents strongly perceived a need for consolidated financial statements, and close corporations with a narrow financial statement user base, for which respondents strongly did not perceive a need for consolidated financial statements, (ii) user base, and (iii) entity form, except with respect to the smallest of entities with a narrow user base, for which respondents strongly did not perceive a need for consolidated financial statements.

The results indicate that RA&As strongly perceive a need for differential corporate reporting requirements in respect of the requirement to prepare consolidated financial statements based on entity size, financial statement user base, and entity form. This finding supports the current multi-tiered company proposals of the South African Department of Trade and Industry (DTI,2004), the thresholds for and reporting requirements of which, are currently being investigated by the SAICA (SAICA,2004d).

6.7 Comparisons to previous studies

6.7.1 The Hattingh study (South Africa)

The Hattingh study was limited to an investigation of the form that differential reporting may take. Hattingh (2002b) surveyed 2 286 participants at SAICA's 2001 accounting technical update. Respondents were required to elect the most desirable and second most desirable form that differential corporate reporting may take in South Africa. The results of that study are reproduced in table 6-13.

Unlike the Hattingh study, this study required the rating of the suitability of five alternative possible forms of differential corporate reporting using a five point Likert scale, as set out in chapter 5. Due to the different research methods adopted in the two studies, meaningful comparison was, in the first instance, made between the rankings that resulted from each study (see table 6-13).

Both studies found limited formalised deviations from SA GAAP to be the most suitable form that South African differential reporting requirements could take. Further, both studies found other options, including the cash basis, to be the least suitable form that South African differential reporting requirements could take. This study found a completely separate set of SA GAAP and the income tax basis to enjoy considerably more support than that found by Hattingh. However, Hattingh found significantly more support for unlimited deviations from SA GAAP.

Table 6-13 Comparison of rankings

	Hattingh Study*			**This Study**	
	Most desirable	**Second most desirable**	**Ranking**	**Ranking narrow user base (from table 6-4)**	**Ranking wide user base (from table 6-5)**
Other options (for example, cash basis)	0%	2%	5	5	5
Unlimited deviations from SA GAAP	19%	42%	2	4	4
Income tax basis	4%	12%	4	3	3
Limited deviations from SA GAAP	71%	22%	1	1	1
Completely separate set of SA GAAP	6%	22%	3	2	2
	100%	100%			

* Source: Hattingh (2002b)

Using the data presented in table 6-13, the number of respondents to the Hattingh study that rated each of the differential reporting options most desirable or second most desirable was determined. Comparable data from this study was prepared by selecting each of the respondents two most highly rated differential corporate reporting options from the summated scores of each respondent's ratings in respect of a private company with a narrow user base and a private company with a wide user base. The respondents' perceptions of the two most suitable possible

forms that South African differential reporting may take were thereby established on a comparable basis (refer to table 6-14). This enabled a statistical comparison of the results of the two studies to be performed.

Chi-square testing at the ninety-five percent level of confidence found significant differences between the results of this study and those of the Hattingh study. Possible reasons for these differences include: (i) interviewer bias, Hattingh acknowledges some interviewer bias, (ii) differences in the research methodologies, (iii) the increased complexity of SA GAAP in the intervening period, and (iv) differences in the populations tested, that is, although both populations were accountants, the population of this study was limited to RA&As.

Table 6-14 Comparison to Hattingh study

	Hattingh Study Most desirable or second most desirable		**Difference**	**This Study Most desirable or second most desirable**	
	Frequency	**%**	**%**	**Frequency**	**%**
Other options (for example, the cash basis)	46	1	6	9	7
Unlimited deviations from SA GAAP	1 394	30	(24)	8	6
Income tax basis	366	8	15	29	23
Limited deviations from SA GAAP	2 126	47	(13)	43	34
Completely separate set of SA GAAP	640	14	16	39	30
	4 572	100		128	100

6.7.2 The Abdel-Khalik study (United States of America)

A direct statistical comparison cannot be made to the Abdel-Khalik study (reported in Carsberg *et al*, 1985), as the research focus and design of the two studies are too different. Other complicating factors include the substantial time gap between the two studies and differences between the national GAAP of the jurisdictions in which the studies were undertaken. However, certain of the relevant main findings of the Abdel-Khalik study are consistent with the results of this study and thereby provide some corroboration of the results of this study. For example: i) Generally, accountants support the notion of differential corporate reporting; and ii) Users believe the requirements of certain accounting standards to be excessive for small companies.

6.7.3 The Carsberg *et al* study (United Kingdom)

A direct statistical comparison cannot be made to the Carsberg, Page, Sindall and Waring (1985) study, as the research focus and design of the two studies are too different. Other complicating factors include the substantial time gap between the two studies and differences between the national GAAP of the jurisdictions in which the studies were undertaken. However, certain of the relevant main findings of the Carsberg *et al* study are consistent with the results of this study and thereby provide some corroboration of the results of this study. For example: i) Support for the notion of differential corporate reporting; ii) The requirements of certain accounting standards were found to be excessive for small companies; and iii) Little relief is achieved where small companies are exempted from the presentation and disclosure requirements of an item that required measurement.

In common with this study, Carsberg *et al* found support for differential corporate reporting taking the form of limited formalised deviations from GAAP. Unlike this study, Carsberg *et al* did not find a separate set of GAAP to be an appropriate differential corporate reporting solution. This difference is substantial as two subpopulations of this study, namely, small accounting practices and RA&As with more than twenty years experience, rated a completely separate set of SA GAAP to be the most suitable form that South African differential corporate reporting may take irrespective of the width of the financial statement user base (refer to tables 6-6 to 6-8).

6.7.4 The Holmes *et al* study (Australia)

A direct comparison can be made to the Holmes, Kent and Downey (1991) study, as the research focus and design of the two studies are similar. However, the results of such a comparison must be interpreted with caution particularly as there is a substantial time gap between the two studies and as significant differences exist between the national GAAP of the jurisdictions in which the studies were undertaken.

Both studies found that registered accountants strongly perceived a need for differential reporting. However, some differences in the suitability of alternative possible forms of differential reporting were found. As this study tested more variables (that is, possible determinants for differential corporate reporting thresholds) than those tested for in the Holmes *et al* study, direct comparisons of perceptions of the thresholds for differential reporting is difficult. As the Australian GAAP used in the Holmes *et al* study may differ substantially from

the SA GAAP used in this study, direct comparison of the content of differential corporate reporting is compromised. A comparison of the findings in respect of each of the major sections common to both studies is set out below under appropriate headings.

6.7.4.1 Desirability

Both studies first asked whether the responding accountants perceived a need for differential corporate reporting requirements. In both studies approximately 97% answered yes (refer to table 6-15).

Table 6-15 Desirability of Differential Reporting

	Holmes *et al* Study	This Study
	Yes	Yes
Do you perceive a need for differential reporting requirements?	97%*	97%

* Holmes *et al* (1991:128)

6.7.4.2 Form

The Holmes *et al* study did not seek to investigate the suitability of different forms that differential reporting may take, except to the extent that they specifically investigated the suitability of the income tax basis.

Holmes *et al* found that sixty percent of accountants answered no to the question "would it be appropriate to base differential reporting guidelines upon the requirements of the Income Tax Act?" and reported this finding significant at the ninety-five percent level of confidence (Holmes *et al*,1991:130). In contrast with the Holmes *et al* study, this study found some support for the income tax basis for private companies particularly where the financial statement user base is narrow (refer to table 6-6 and table 6-8).

6.7.4.3 Threshold

The Holmes *et al* study performed global chi-square tests at the ninety-five percent level of confidence for significant differences between practising accountants' perceptions of the applicability of twenty-three Australian accounting standards to six hypothetical entities varied by size and legal structure. The results of the global chi-square tests are presented in table 6-16.

Table 6-16 Significant differences between responses for six business types

	A	B	C	D	E	F
	Public Co.	Public Co.	Private Co.	Private Co.	Sole Trader	Sole Trader
Firm	$10 000 000	$500 000 000	$100 000	$50 000 000	$50 000	$200 000
A		#	*	*	*	*
B			*	*	*	*
C				*	*	*
D					*	*
E						#

Notes:

* indicates that the result of chi-square testing is significant at the 95% confidence level

# indicates that the result of chi-square testing is not significant at the 95% confidence level

$ - turnover

Source: Derived from Holmes *et al* (1991:129)

The results of comparable chi-square tests performed in this study are presented in table 6-11. Both studies found support for differential corporate reporting in respect of both size and legal structure. As the Holmes *et al* study did not test perceptions of user base as a possible differential corporate reporting threshold determinant, a comparison of that variable between the two studies cannot be undertaken.

Both studies found that public accountants perceived a need to differentiate the reporting requirements of large private companies from those of small private companies. With respect to entity forms other than private companies, except in this study for close corporations with users (refer to table 6-11), both studies found that practising accountants do not perceive a differential corporate reporting threshold in respect of entity size on its own. As the Holmes *et al* study did not test perceptions of user base as a possible differential corporate reporting threshold determinant and, as there was a significant difference between responses in respect of big, that is, entity J in table 6-11, and small, that is, entity L in table 6-11, close corporations with users, it cannot be concluded that this is a difference between the findings of the two studies.

Both studies found that public accountants perceived a need to differentiate the reporting requirements of public companies, that is, entities A to D in table 6-11 and entities A and B in table 6-16, from those of all other entity forms, that is, entities E to L in table 6-11 and entities C to F in table 6-16. With respect to other entity forms other than between small private companies and small close corporations irrespective of the width of the user base, that is, entity G compared with entity K and entity H compared with entity L in table 6-11, both studies found

that practising accountants perceive a need for differential corporate reporting thresholds in respect of entity form. As the Holmes *et al* study did not specifically test perceptions of an entity form differential corporate reporting threshold between close corporations and private companies, it cannot be concluded that this is a difference between the findings of the two studies.

6.7.4.4 Content

The Holmes *et al* study analysed practising accountants' perceptions of the applicability of twenty-three Australian accounting standards to six hypothetical entities varied by size and legal structure. A summary of the practising accountants' responses by Australian accounting standards is presented in table 6-17.

This study analysed RA&As' perceptions of the applicability of fifteen statements of SA GAAP to twelve hypothetical entities varied by size, legal structure and financial statement user base. A summary of the RA&As' responses by statement of SA GAAP is presented in table 6-10.

As the level of detail in this study exceeded that of the Holmes *et al* study, some of the categories of this study (refer to table 6-10) were combined for purposes of overall comparison with the Holmes *et al* study (refer to table 6-18). These combinations were necessary, as Holmes *et al* did not differentiate securities exchange listed public companies from unlisted public companies. In addition, Holmes *et al* did not differentiate private companies whose financial statements have a wide financial statement user base from those with a narrow financial statement user base. As comparable information was not collected for close corporations in the Holmes *et al* study and for sole traders in this study, these entity types are excluded from the comparison presented in table 6-18.

The mean appropriateness ratings across all accounting standards tested for and the rankings thereof (refer to table 6-18) of this study are consistent with those of the Holmes *et al* study. This indicates overall consistency in the findings of the two studies. To ascertain if the consistencies extend to particular accounting issues, a comparison of the acceptability ratings for individual accounting standards was made in respect of big private companies (refer to table 6-19) and small private companies (refer to table 6-20). Comparison of the findings of the two studies in respect individual accounting standards must be interpreted with caution as: (i) there is a substantial time gap between the two studies; (ii) accounting standards have evolved rapidly in the intervening period; and (iii) differences in the national GAAP of the two jurisdictions exist.

Table 6-17 Standards appropriate

	Public Company		Private Company		Sole Trader	
Standard	**Small**	**Big**	**Small**	**Big**	**Small**	**Big**
	A	**B**	**C**	**D**	**E**	**F**
	%	**%**	**%**	**%**	**%**	**%**
AAS 1 – Profit and loss	**96**	96	85	92	68	70
AAS 2 – Inventories	**90**	92	77	80	66	69
AAS 3 – Taxation	**93**	93	75	86	63	66
AAS 4 – Depreciation	**93**	93	67	82	50	56
AAS 5 – Materiality	**92**	92	50	74	35	39
AAS 6 – Accounting policies	**93**	93	58	80	30	35
AAS 7 – Extractive industries	**87**	88	50	63	29	29
AAS 8 – Events after balance sheet date	**93**	91	50	76	28	30
AAS 9 – Expenditure carried forward	**93**	93	50	68	26	30
AAS 10 – Revaluation of non-current assets	90	91	46	70	24	26
AAS 11 – Construction contracts	92	93	47	70	24	26
AAS 12 – Sources and applications of funds	89	89	48	65	24	25
AAS 13 – Research & development	87	90	39	64	22	23
AAS 14 – Equity method	92	92	44	68	21	23
AAS 15 – Disclosure of operating revenue	81	82	40	58	19	22
AAS 16 – Financial reporting by segment	**88**	91	42	67	17	21
AAS 17 – Leases	**87**	88	35	62	17	18
AAS 18 – Goodwill	**88**	89	35	56	15	17
AAS 19 – Joint ventures	**89**	90	31	58	14	20
AAS 20 – Foreign currency translation	**89**	89	36	59	10	11
AAS 21 – The acquisition of assets	89	91	30	55	**5**	5
AAS 22 – Related party disclosures	81	87	18	50	**4**	8
AAS 23 – Set-off & extinguishment of debt	**76**	79	13	37	1	1
Mean	**89**	**90**	**46**	**67**	**27**	**29**
Rank	**2**	**1**	**4**	**3**	6	5

Source: Derived from Holmes *et al* (1991:129)

Table 6-18 Comparison of mean scores of the appropriateness of standards

Mean of acceptability ratings of Accounting Standards	**Public Company**		**Private Company**	
	Large	**Small**	**Large**	**Small**
	%	**%**	**%**	**%**
Big JSE listed company#	**95**			
Small JSE listed company#		**94**		
Big public company#	**92**			
Small public company#		**87**		
Big private company with a narrow user base#			**56**	
Big private company with a wide user base#			**73**	
Small private company with a narrow user base#				32
Small private company with a wide user base#				47
Total	**187**	**181**	**129**	79
Mean this study	**94**	**91**	**65**	**40**
Rank	**1**	**2**	**3**	4
Mean Holmes *et al* study*	**90**	**89**	**67**	**46**
Rank	**1**	**2**	**3**	4

from table 6-10

* from table 6-17

An examination of the responses (refer to table 6-10 for this study and table 6-17 for the Holmes *et al* study) indicates that significantly more accountants support all the individual statements of GAAP for public companies.

Holmes *et al* found that, except for AAS 16 - Financial reporting by segment and AAS 14 - Equity method of accounting, all Australian standards were considered appropriate for big private companies (refer to table 6-19). This study, which excluded the South African statement governing segmental reporting, found that RA&As considered each statement of SA GAAP tested for, to be appropriate for big private companies with a wide financial statement user base (refer to table 6-19). However, where the financial statement user base of a big private company was narrow, six statements of SA GAAP were considered inappropriate (refer to table 6-19). Only for AC 128 - Impairment of assets (SAICA, 1999e) was this inappropriateness limited to the presentation and disclosure requirements. For the other five statements of GAAP, both the presentation and disclosure requirements and the recognition and measurement requirements of the standards were perceived to be inappropriate.

Like Holmes *et al* (1991:130) this study found that many of the statements of GAAP are perceived to be inappropriate to small private companies. Table 6-20 presents those statements of GAAP that were perceived to be appropriate for small private companies. The acceptability of the statement of GAAP on inventory and the depreciation aspects of the statement of GAAP on property, plant and equipment are common to both studies.

The most important finding of this study in respect of the possible content of differential corporate reporting, is that RA&As perceive the need for differential corporate requirements equally in respect of the recognition and measurement requirements and the presentation and disclosure requirements of SA GAAP. As Holmes *et al* did not collect perceptions about the applicability of the presentation and disclosure separately from recognition and measurement, a comparison to that study on this issue cannot be made.

Table 6-19 Comparison of statements of GAAP inappropriate to big private companies

	This study						Holmes *et al* study*	
	Wide user base			Narrow user base				**Comments**
Standard found to be inappropriate	**P&D**	**R&M**	**Whole**	**P&D**	**R&M**	**Whole**	**Whole**	
AC 116 - Employee benefits				√	√	√		At the time of the Holmes *et al* study no equivalent Australian standard existed.
AC 126 - Related party disclosures						√		Holmes *et al* (1991:129) found the equivalent Australian standard (AAS 22) appropriate.
AC 125 & AC 133 - Financial instruments				√	√	√		At the time of the Holmes *et al* study no equivalent Australian standard existed.
AC 128 - Impairment of assets				√				At the time of the Holmes *et al* study no equivalent Australian standard existed.
AC 132 - Consolidated financial statements						√		At the time of the Holmes *et al* study no equivalent Australian standard existed.
AC 137 - Agriculture				√	√	√		At the time of the Holmes *et al* study no equivalent Australian standard existed.
AAS 14 - Equity method of accounting							√	The SA GAAP equivalent was not tested for.
AAS 16 - Financial reporting by segment*							√	The SA GAAP equivalent was not tested for as it applies only to listed entities.

√ = Inappropriate

* Holmes *et al* (1991:130)

Table 6-20 Comparison of statements of GAAP appropriate to small private companies

	This study						Holmes *et al* study	
	Wide user base			Narrow user base				**Comments**
Appropriate Standards	**P&D**	**R&M**	**Whole**	**P&D**	**R&M**	**Whole**	**Whole**	
AC 102 - Income taxes				√	√	√		Holmes *et al* (1991:129) found AAS 3 to be inappropriate.
AC 105 - Leases				√	√	√		Holmes *et al* (1991:129) found AAS 17 to be inappropriate.
AC 108/AAS 2 - Inventories	√	√	√	√	√	√	√	
AC 123 - Property, plant and equipment	√	√	√	√	√	√		Holmes *et al* (1991:129) found AAS 4 to be appropriate and AAS 10 to be inappropriate.
AAS 4 - Depreciation of non-current assets							√	This study found AC 123 to be appropriate and AC 129 - Intangible assets to be inappropriate. However, AC 123 and AC 129 are not limited to the depreciation aspects of the affected non-current assets.
AC 130 - Provisions and contingencies				√	√	√		At the time of the Holmes *et al* study no equivalent Australian standard existed.
AC 118 - Cash flow statement						√		Holmes *et al* (1991:129) found AAS 12 - Statement of sources and applications of funds to be inappropriate.
AC 132 - Consolidated financial statements						√		At the time of the Holmes *et al* study no equivalent Australian standard existed.
AAS 1 - Profit and loss							√	The SA GAAP equivalent was not tested for.
AAS 5 - Materiality							√	The SA GAAP equivalent was not tested for.
AAS 8 - Events occurring after balance sheet date							√	The SA GAAP equivalent was not tested for.

√ = appropriate

6.7.5 CICA's research report

6.7.5.1 Desirability

Both studies found a need for differential reporting. Both studies found that the practitioners studied perceived GAAP as too complicated and onerous for small business enterprises (SBEs) with some requirements of GAAP being of little relevance to SBEs. Unitary GAAP therefore would result in SBEs incurring costs of compliance with GAAP that exceed the benefits to be derived therefrom by SBE financial statement users. CICA's study extended to other users of SBEs financial statements, notably bankers (Lavigne,1999:49).

6.7.5.2 Form

Both studies investigated perceptions of the suitability of various forms that differential reporting may take. A comparison of the suitability ratings of possible alternative forms that differential reporting may take tested for in the two studies, are presented in table 6-21.

6-21 Suitability of alternative forms

	This study	CICA's study*
Limited formalised deviations from GAAP	Suitable	Suitable
A completely separate set of GAAP	Suitable	Unsuitable
General-purpose financial statements prepared in accordance with a basis of accounting other than GAAP. For example, cash basis or tax basis	Tax basis - suitable in limited circumstances, otherwise unsuitable	Unsuitable
Other bases	Unsuitable	Unsuitable

* Derived from Lavigne (1999:49-50)

Both studies found support for differential reporting taking the form of limited deviations from GAAP. CICA's study found this to be the only form of differential reporting that was acceptable to the SBE financial reporting stakeholders consulted (Lavigne:1999:50). Overall, this study also found this form of differential reporting preferable to all others. However, unlike the CICA's study, this study also found support for a completely separate set of GAAP and to a lesser extent the income tax basis. The CICA's study found a separate set of accounting standards for SBEs undesirable (Lavigne:1999:50).

6.7.5.3 Threshold

Both studies found public accountability to be an appropriate differential reporting threshold determinant. However, unlike this study which found that South African RA&As perceive entity size to be an appropriate differential reporting threshold determinant, the CICA study considered and rejected a size test. CICA justifies differential reporting options by users' characteristics rather than entity size (Mersereau,2002:31).

Unlike the CICA's study, this study found some evidence that more than one differential reporting threshold may be appropriate. In particular, big private companies with a wide financial statement user base may have unique financial reporting requirements. This finding supports the current multi-tiered company proposals of the South African Department of Trade and Industry (DTI,2004), the thresholds for which are currently being investigated by the SAICA (2004d).

6.7.5.4 Content

The CICA study found that differential reporting options should normally pertain only to presentation and disclosure requirements. However, CICA acknowledged that it was not impossible that some future recognition or measurement requirements would not meet the needs of SBEs or the cost/benefit effectiveness test (Lavigne,1999:50). However, in practice, CICA has implemented significant recognition and measurement differential reporting options. For example, CICA's first batch of six differential reporting options (CICA,2002a:appendix A) contained four differential reporting options that had recognition and measurement implications (Mersereau,2002:30). The CICA's practice of implementing recognition and measurement concessions for SBEs is consistent with the findings of this research. This research found an equally strongly perceived need for differential corporate reporting in respect of recognition and measurement requirements and the presentation and disclosure requirements of SA GAAP.

The CICA study recommended limited targeted relief for SBEs from selected sections of Canadian GAAP. This study found that RA&As perceived a significant difference between the reporting requirements of private companies and public companies. Only in the case of a public company, comparisons with a big private company with a wide financial statement user base was significant difference limited to a minimum of sixty-three percent of the twenty-seven GAAP requirement suitability tests conducted (refer to table 6-12). In all other cases, significant differences were found in respect of each of the twenty-seven GAAP requirement suitability tests conducted for each private-public company entity type comparison. The findings of this

research suggests that significantly more differential reporting options may be appropriate in the South African context. However, differences in the research methodologies and populations of the two studies may account for the differences between the findings of the two studies. This finding may support the current multi-tiered company proposals of the South African Department of Trade and Industry (DTI,2004), the reporting requirements of which, are currently being investigated by the SAICA (SAICA,2004d).

6.7.6 IASB's project

6.7.6.1 Desirability

Both studies found a strongly perceived need for differential reporting. The IASB surveyed the perceptions of national standard-setters. This study surveyed the perceptions of South African RA&As.

6.7.6.2 Form

Both studies found a preference for differential reporting taking the form of limited deviations from GAAP. The IASB's study found that national standard-setters perceive a preference for a single global set of SME GAAP taking the form of a standalone document rather than add-ons to existing IFRS (Pacter:2004:119).

Unlike the IASB's study, this study found support for differential reporting taking the form of a completely separate set of GAAP, that is, designed without reference to GAAP. This study also found limited support for differential reporting requirements taking the form of the income tax basis.

6.7.6.3 Threshold

The IASB preliminary view is that no public accountability should be the differential reporting threshold determinant for the use of IASB SME Standards (IASCF,2004:para28). However, the IASB is also of the preliminary view that national jurisdictions should determine whether all, or only some, entities that do not have public accountability should be required or permitted to use IASB SME Standards (para26). The IASB's preliminary views therefore make provision for national jurisdictions to set multiple differential reporting thresholds some of which may be determined other than by application of the no public accountability principle. Consequently,

the development of multiple differential reporting thresholds in a national jurisdiction does not conflict with the preliminary views of the IASB.

The findings of this study, that no single factor is perceived by RA&As to be paramount to the determination of differential corporate reporting thresholds and that a matrix of entity size, entity form and financial statement user base are collectively significant in a common direction does not conflict with the preliminary views of the IASB.

The finding of this study that more than one differential reporting threshold may be appropriate in the South African context also does not conflict with the IASB's preliminary views. In particular, this study found big private companies with a wide financial statement user base to have unique financial reporting requirements.

6.7.6.4 Content

Both studies found that respondents perceived the need for differential reporting options for both the presentation and disclosure requirements and the recognition and measurement requirements of qualifying entities. However, the IASB subsequently took the preliminary view that although it is likely that presentation and disclosure modifications will be implemented, there is a rebuttable presumption that no recognition and measurement modifications shall be made (IASCF,2004). As modifications are justified on the basis of identified needs of users or cost-benefit analysis, the author considers it likely that the rebuttable presumption shall be overcome and that recognition and measurement modifications will be justified. This viewpoint is supported by the Canadian experience discussed in the preceding subsection, as well as the results of both the IASB's research and this research study.

6.8 Overall assessment of the research findings

This research endeavoured to determine the attitudes of RA&As to four aspects of differential corporate reporting in South Africa, namely: (i) the need for differential corporate reporting; (ii) the form that differential corporate reporting should take; (iii) the determination of the differential corporate reporting threshold; and (iv) limited aspects of possible differential corporate reporting requirements. The findings of this research are intended to provide a basis for further investigation into the development of South African differential corporate reporting requirements. Recommendations emerging from this study and suggestions for further research are presented in chapter 7. To ensure that the results of the research are accurate and grounded

in relevant theory, and therefore from which valid conclusions can be drawn and meaningful recommendations made, critical aspects of the research process were revisited, including the following:

1) The adequacy of the theory. Re-examination of the theory underlying this research confirms the adequacy of the theory as it fits together logically.
2) The adequacy of the hypotheses. Reconsideration of the research hypotheses confirms the adequacy thereof as they are clearly defined and logically derived from the theory in which they are couched.
3) The representativeness of the sample. Reconsideration of the sampling method in the context of statistical theory confirms the representativeness thereof.
4) The adequacy of the research instrument. Reconsideration of the questionnaire confirms the adequacy thereof as the questions contained therein were derived from prior research and appropriate pre-testing was undertaken.
5) The adequacy of the statistical testing. Reconsideration of the appropriateness of the statistical measures used in the context of statistical theory confirms the appropriateness thereof. However, the low response rate is of some concern.
6) The appropriateness of the levels of significance used. Reconsideration of the levels of significance used in the context of statistical theory confirms the appropriateness thereof.

Based on the findings of the reassessment of the research process set out above, the results of this research can be regarded as valid and the findings can be relied upon.

6.9 Summary

This chapter presented, analysed and evaluated the results of this research study.

Firstly, the respondent demography was analysed and found to represent a broad spectrum of RA&As. The demographic information collected was cross-tabulated with selected data obtained from the survey. The cross-tabulations provided a more detailed analysis of the perceptions of the subpopulations towards the various aspects of differential corporate reporting investigated.

The analysis presented in the next section showed that RA&As strongly perceive a need for differential reporting requirements in South Africa. This perception was found to be consistent with prior research conducted in South Africa and abroad.

The analysis presented in the next section showed that overall RA&As perceive limited deviations from SA GAAP to be the most suitable form that differential reporting may take. In contrast to the findings of prior South African and overseas research, support was also found for differential reporting to take the form of a completely separate set of SA GAAP. In limited circumstances, some subpopulations were also found to support the income tax basis.

The analysis presented in the next section showed that RA&As do not perceive a single factor to be paramount to the determination of the differential reporting threshold. RA&As perceived a matrix of entity size, entity form and user base collectively significant in a common direction. The findings of this research also suggest the existence of more than one differential reporting threshold in the South African context.

Lastly, the attitudes of RA&As to selected detailed differential reporting requirements were analysed. RA&As were found to perceive the need for differential reporting requirements in respect of both the presentation and disclosure requirements and the recognition and measurement requirements of SA GAAP. Although standard-setters have traditionally found recognition and measurement modifications conceptually difficult to justify, this finding is supported by the recent financial reporting pronouncements of a few progressive national standard-setters. Further, a recent international survey of national standard-setters perceptions found substantial support in principle for recognition and measurement differential reporting concessions.

The overall assessment of the results of this research that concludes this chapter indicates that the results of this research can be regarded as valid and the findings can be relied upon. These findings support the recommendations presented in chapter 7.

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Chapter 7

SUMMARY, CONCLUSIONS AND RECOMMENDATIONS

7.1 Summary and conclusions

To satisfy the twenty-first century information needs of divergent broadly based financial statement user groups, many of which are not in a position to demand additional information from the entity, South African statements of generally accepted accounting practice (SA GAAP) are necessarily complex and increasingly voluminous. However, it is increasingly acknowledged that GAAP is not appropriate to all entities and that compliance therewith can result in substantial costs being incurred without sufficient, if any, benefit. For this reason, some jurisdictions have established differential corporate reporting requirements whereby qualifying entities are permitted to apply different requirements in the preparation of their financial statements. However, the differential corporate reporting requirements of different jurisdictions vary greatly not only in the determination of which entities qualify to apply less onerous reporting requirements but also in the form and content of the differential reporting requirements. Further, there is much dissatisfaction with existing differential reporting requirements of most jurisdictions.

In South Africa, the issue of differential corporate reporting is relatively new with very little scientific research having been undertaken. The South African Department of Trade and Industry is currently considering the implementation of differential corporate reporting requirements as part of the country's corporate law reforms. The South African Institute of Chartered Accountants (SAICA) contributed to the differential corporate reporting aspects of the corporate law reforms by developing limited purpose financial reporting standards and exposing them for public comment. However, this effort was superseded by the International Accounting Standards Board's (IASB's) differential reporting project. The IASB intend developing standards derived from its international financial reporting standards (IFRS) that are applicable to small and medium-sized entities globally (IASB SME Standards). The SAICA endorse the IASB's proposal and, as part of the South African corporate law reforms, are currently investigating the thresholds for and reporting requirements of, possible different tiers of South African companies.

This study was conducted in two parts. In the first part relevant literature was reviewed and in the second part, South African RA&As' perceptions of differential corporate reporting were investigated. The sections that follow summarise the salient features of these two parts.

7.1.1 Literature review

Archival research was used to collect information that contributed to a better understanding of differential corporate reporting in South Africa. This information also provided a frame of reference for the second part of the study.

In conducting the literature review, South African corporate reporting requirements were first reviewed to provide the legal framework in which corporate financial reporting currently takes place in South Africa. This review also identified the extent to which South African differential corporate reporting requirements pre-exist.

In the third chapter, current South African differential corporate reporting proposals were reviewed. This provided the probable future legal framework in which South African corporate financial reporting may take place in the foreseeable future. Particular attention was given to the proposed differential corporate reporting proposals of: (i) the draft financial reporting bill; (ii) the corporate law reforms; and (iii) the differential corporate reporting proposals and preliminary views issued for public comment by the SAICA and the IASB.

In the fourth chapter, to provide a frame of reference, the development of differential corporate reporting practices globally was traced and the current differential corporate reporting practices of influential standard-setting bodies whose GAAP have followed a similar evolutionary path to SA GAAP were established. Further, to provide a basis for comparison, the most influential differential reporting research studies that gave direction to the development of differential reporting globally were broadly reviewed. The research found that although the need for differential corporate is increasingly acknowledged, there is little consistency in its practice internationally. Inconsistencies were found between the differential reporting options of the jurisdictions examined and the criteria that are applied to determine which entities qualify for differential reporting options.

The conclusions drawn from this review are as follows:

- There is increasing acceptance of the need for differential corporate reporting options.

- There is little consensus about which entities should qualify for differential corporate reporting options.
- There is little consensus as to what the detailed reporting requirements of entities that qualify for differential corporate reporting options should be.
- The lack of differential corporate reporting options in South Africa is inconsistent with current global reporting requirements and may cause certain South African entities to incur unnecessary reporting costs which their trading partners are not subjected to.
- A need exists for the investigation of differential corporate reporting in South Africa to provide a basis for informed decision making by the law makers and to provide some guidance to those who may in future set differential financial reporting standards for South African corporate entities.

7.1.2 Postal opinion research

Postal survey research was used to determine the attitudes of RA&As of differential corporate reporting in South Africa. The four main subcategories in which the opinions of RA&As were investigated are:

- The need for differential corporate reporting.
- The form/s that differential corporate reporting requirements should take.
- The threshold/s for differential reporting.
- Limited aspects of the detailed requirements of limited purpose financial reporting standards.

The research methodology used to determine the attitudes of RA&As to differential corporate reporting in South Africa is set out in chapter 5. The research findings resulting from the application of the research methodology are presented and analysed in chapter 6. A summary of these findings is presented in the sections that follow.

7.1.2.1 Desirability

RA&As almost unanimously perceived a need for differential corporate reporting requirements in South Africa, the irrelevance/inappropriateness of SA GAAP to small/owner-managed businesses being the most commonly cited reason in support of differential corporate reporting requirements. Other commonly cited reasons include: (i) the costs of compliance with SA GAAP exceeding the benefits; and (ii) SA GAAP being too complex and/or onerous.

Based on the results of this study, which are corroborated by the findings of a less formal prior South African study and similar prior studies in other countries that have similar national GAAP, its is concluded that a need obviously exists for differential corporate reporting in South Africa.

7.1.2.2 Form

The above stated need is likely to result in differential corporate reporting requirements being legislated in South Africa. Evidence of this is found in the proposals of the draft financial reporting bill and the corporate law reforms discussed in chapter 3. However, considerably less consensus exists about the form that differential corporate reporting should take.

Guided by the proposals of the draft financial reporting bill, this study limited its investigations of RA&As' opinions about the form, that differential corporate reporting may take, to private companies.

Ranking responses recorded on a five point Likert scale by overall mean scores, limited deviations from SA GAAP was found to be the most desirable form that differential corporate reporting may take. However, a completely separate set of SA GAAP was rated the most desirable by respondents from small practices and respondents with greater than twenty years experience. Further, the respondents as a whole most frequently rated a completely separate set of SA GAAP very suitable. Limited support was also found for the income tax basis of differential reporting where the financial statement user base is narrow. These ratings may indicate that more than one alternative basis of preparation may be appropriate to entities that qualify for differential reporting options, as is the case in the United States of America.

The finding that more than one form of differential corporate reporting may be appropriate is consistent with the current South African corporate law reform that proposes that different tiers of corporate entities should be identified, each having its own reporting requirements. This finding suggests that different forms of differential corporate reporting may be appropriate for different tiers of corporate entities.

The cash basis and unlimited deviations from SA GAAP were rated unsuitable by all respondent subpopulations irrespective of the extent of the financial statement user base. However, more detailed research is required to determine if either of these forms is not appropriate to, for

example, the smallest tier of corporate entity to be identified under South Africa's current corporate law reform.

Based on the results of this study, it is concluded that these findings provide some support for the preliminary view of the IASB (IASCF,2004) and the proposal of the SAICA (SAICA,2003a) that differential reporting should take the form of limited deviations from GAAP. However, the findings also highlight that this approach is closely contested and not shared by all subpopulations. Consequently, more research needs to be undertaken before definitive conclusions on this complex issue can be reached.

7.1.2.3 Threshold

Unlike the investigation of RA&As' perceptions of the form that differential corporate reporting may take, the investigation of RA&As' perceptions of which entities should qualify for differential corporate reporting options was not limited to a single entity form. This investigation involved RA&As evaluating the applicability of selected statements of SA GAAP for twelve hypothetical entities varied by entity form, financial statement user base, and entity size.

The results of chi-square testing at the ninety-five percent level of confidence found significant differences between the perceived applicability of SA GAAP to public companies, including securities exchange listed companies, when compared with private companies and close corporations, irrespective of entity size and the width of the financial statement user base. This finding supports a public-private company differential corporate reporting threshold. The finding is consistent with the proposal of the draft financial reporting bill that limited purpose financial reporting standards be used by qualifying private companies.

Significant differences were also found between the perceived applicability of SA GAAP to a big private company with a wide financial statement user base and all other hypothetical entities. This indicates that RA&As may perceive reporting requirements unique to big private companies that have wide user bases.

This research also found that RA&As perceived no single factor to be paramount to the determination of differential corporate reporting thresholds and that a matrix of entity size, entity form and financial statement user base are collectively significant in a common direction. A single threshold for differential corporate reporting may therefore not adequately address the South African differential corporate reporting needs. Multiple differential corporate reporting

thresholds each with its own reporting requirements, may be the most comprehensive solution. This finding supports the current multi-tiered company proposals of the South African Department of Trade and Industry (DTI,2004), the thresholds for and reporting requirements of which are currently being investigated by the SAICA (SAICA,2004d). Further, this finding is not in conflict with the IASB preliminary view that no public accountability should be the differential reporting threshold determinant for the use of IASB SME Standards (IASCF,2004:para28) as the IASB preliminary views provide that national jurisdictions may set multiple differential reporting thresholds some of which may be determined other than by the application of the no public accountability principle.

The following conclusions are based on the results of this study:

- More than one differential corporate reporting threshold should be implemented in South African corporate reporting framework.
- In determining the differential corporate reporting thresholds, it is appropriate to consider entity form, entity size and public accountability, for example, the width of the financial statement user base. However, not all of these factors are necessarily applicable to the determination of each differential corporate reporting threshold.
- Further research needs to be conducted to determine the thresholds for differential corporate reporting in South Africa.

7.1.2.4 Content

This research found a strongly perceived need for differential corporate reporting requirements in respect of both the presentation and disclosure requirements and the recognition and measurement requirements of SA GAAP. This finding is contrary to the rebuttable presumption in the preliminary view of the IASB that no recognition and measurement modifications will be made in IASB SME Standards.

The research found that RA&As perceive the requirement to prepare a cash flow statement appropriate to all public companies, all private companies, except small private companies with a narrow user base, and big close corporations that have a wide financial statement user base. This finding supports the current multi-tiered company proposals of the current South African corporate law reform.

The research found that RA&As perceive a need differential corporate reporting requirements in respect of the requirements of SAICA (2000d), that is, AC 126 particularly where there is a

limited financial statement user base. This finding is contrary to SAICA (2003a), that is, ED 163 that does not propose any exemptions from the requirements of AC 126. However, this finding supports the current multi-tiered company proposals of the current South African corporate law reform.

The research found that RA&As perceive the requirement to prepare consolidated financial statements to be inappropriate for all close corporations and all private companies with a limited user base. Further, RA&As strongly perceive a need for differential corporate reporting requirements in respect of the requirement to prepare consolidated financial statements based on entity size, financial statement user base and entity form. This finding supports the current multi-tiered company proposals of the current South African corporate law reform.

Based on the results of this study, it is concluded that:

- For differential corporate reporting options to provide meaningful relief to qualifying entities, both recognition and measurement and presentation and disclosure concessions must be considered.
- Further research is required to determine the appropriate detailed reporting requirements of each of the tiers of companies to be developed in accordance with South Africa's current corporate law reforms.

The recommendations developed from these conclusions are presented in the next section.

7.2 Recommendations

The following recommendations regarding differential corporate reporting in South Africa are based on the findings of this study:

1) Differential corporate reporting should be implemented in South Africa. Broad-based support for this recommendation is found in South Africa from professional institutes, for example, SAICA (2000b, 2003a) and the Institute of Directors in South Africa (2002) and in prior South African research, for example, Hattingh (2002b) and Cleminson & Rabin (2002). International support for this recommendation is found in many countries already having adopted differential reporting practices, for example, Australia (AARF,1990), Canada (CICA,2002a), New Zealand (ICANZ,2002), and the United Kingdom (ICAEW,2001). Further international support is found in the IASB's current differential reporting project (IASCF,2004).

2) Multiple differential corporate reporting thresholds each with its own reporting requirements, should be established in the development of a comprehensive corporate reporting model for South Africa. This recommendation supports the current multi-tiered company proposals of the South African Department of Trade and Industry (DTI,2004), the thresholds for and reporting requirements of which, are currently being investigated by the SAICA (SAICA,2004d).
3) In the interests of international harmonisation, the IASB SME Standards that are currently in the process of being developed should be considered for adoption for one or more tiers of South African corporate entities. However, careful consideration will need to be given to the applicability of IASB SME Standards to the range of South African corporate entities. IASB SME Standards are likely to be appropriate for the corporate reporting needs of a big private company with a wide financial statement user base. However, IASB SME GAAP is unlikely to be appropriate for the corporate reporting needs of other South African corporate entities, for example, a very small company with a very narrow user base. This recommendation is supported by the IASB's preliminary view that national jurisdictions should determine which entities that do not have public accountability should be required or permitted to follow IASB SME Standards (IASCF,2004:para26).
4) Differential corporate reporting options must address recognition and measurement issues. On their own, presentation and disclosure concessions are unlikely to adequately address the differential corporate reporting dilemma. Support for recognition and measurement concessions is found in this research and elsewhere, for example, CICA (2002a) and ICANZ (2002).
5) To give effect to these recommendations, the appropriate legislation must be amended, that is, the Companies Act and Close Corporations Act and appropriate corporate reporting requirements must be developed for each differential corporate reporting tier provided for in the revised legislation. This recommendation supports the current multi-tiered company proposals of the South African Department of Trade and Industry (DTI,2004), the thresholds for and reporting requirements of which, are currently being investigated by the SAICA (SAICA,2004d).

To give effect to many of these recommendations, further research is necessary. The next section deals with some suggestions for such future research.

7.3 Suggestions for future research

This study was a groundbreaking research effort into the need for differential corporate reporting in South Africa. The results of this research are tentative and more complex and varied research should be undertaken before decisive conclusions on the subject can be drawn. Suggested extensions of this research are set out below.

In the literature review presented in chapter 4, occasional reference was made to prior overseas research of the information needs of primary users of financial statements, for example, Calderon (1990) and Stanga and Tiller (1983) and prior researchers that concluded that certain primary users disagree with accountants over the need for differential corporate reporting (Carsberg, Page, Sindall & Waring,1985:23). However, Hattingh (2002c:29) reported that South African bankers who were initially opposed to differential corporate reporting, changed their minds when presented with additional information on the matter. Further, in chapter 5, a limitation of the survey aspect of this study, being its focus on RA&As' perceptions of selected aspects of the need for differential corporate reporting in South Africa, was discussed. As RA&As are not primary users of financial statements, their opinions may not be representative of primary financial statement users. Therefore, the information needs of primary financial statement users and their attitudes to all aspects of South African differential corporate reporting require investigation.

In presenting future corporate reporting proposals in chapter 3, for example, IASCF (2004) and in presenting the literature review in chapter 4, Koppeschaar (2002:2) and Carsberg *et al* (1985:91) reference was made to the cost benefit constraint as a basis for justifying differential reporting options. However, little research has been conducted into the quantification of the costs and benefits of compliance with SA GAAP. It follows that the costs and benefits of compliance with SA GAAP require empirical investigation.

The research findings presented in chapter 6 shows that RA&As perceived more than one form of differential corporate reporting appropriate for private companies, namely, limited deviations from SA GAAP, a completely separate set of SA GAAP and in limited circumstances, the income tax basis. When analysed further, it was found that certain subpopulations of RA&As preferred different differential reporting options to those preferred by others. By relating the demographics of the subpopulations of RA&As to their clients, it was suggested that more than one differential corporate reporting option may be appropriate for certain entities. Investigation into which differential reporting options are considered appropriate to the primary users of financial statements requires further investigation. Further, investigations should also seek to

measure the balance between the costs and benefits of allowing multiple differential reporting options to qualifying entities.

The South African Department of Trade and Industry (DTI,2004) has proposed the identification of multiple-tiers of companies, the thresholds for and reporting requirements of which are currently being investigated by the SAICA (SAICA,2004d). The findings of this research broadly support this approach to differential corporate reporting in South Africa and provide some guidance as to the appropriateness of a range of differential reporting determinants in the South African context. However, further scientific research is necessary to establish the appropriate number of tiers, the appropriate threshold for and reporting requirements of each of the proposed tiers of companies.

7.4 Overview

This research investigated differential corporate reporting in the South African context. The investigation involved both a review of the relevant literature and a postal questionnaire. The literature review provided the framework for the postal questionnaire that investigated RA&As' perceptions of differential corporate reporting in the South African context.

The study found that there is a strongly perceived need for differential corporate reporting in South Africa. Further, that need was expressed clearly in respect of both the recognition and measurement and the presentation and disclosure requirements of SA GAAP.

Although certain alternate forms of differential reporting were found to be unsuitable for the reporting needs of private companies, others were found to be suitable. Further research is necessary to determine if it is appropriate that more than one differential reporting option should be available to qualifying entities.

Significant differences were found in perceptions of the corporate reporting requirements of sub-groupings of hypothetical entities varied by size, entity form and financial statement user base. This suggests that more than one stratum of differential corporate reporting requirements may be appropriate in the South African context.

Differential corporate reporting should be implemented in South Africa as a matter of urgency. Further research should be conducted into all aspects of differential corporate reporting and the thresholds for and the reporting requirements of the differential corporate reporting stratum should be reviewed and refined in the light of the findings of future research.

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APPENDIX A

COVERING LETTERS

FIRST MAILING

4 November 2002

Dear Sir/Madam

DIFFERENTIAL CORPORATE REPORTING QUESTIONNAIRE

As a Registered Accountant and Auditor, you are probably aware that current draft legislation proposes differential corporate reporting for limited purpose financial statements of South African private companies. However, the form, content and basis of preparation of such limited purpose financial statements are yet to be decided upon, and little South African research into differential reporting has been conducted.

The purpose of this research questionnaire (being carried out in partial fulfilment of a Masters of Accountancy degree) is to provide the scientifically researched view of South African Registered Accountants and Auditors into the differential corporate reporting decision-making process. A good response to this questionnaire is vital. As a Registered Accountant and Auditor, you have the requisite knowledge of South African Statements of Generally Accepted Accounting Practice to meaningfully complete this questionnaire, and understand the implications of differential corporate reporting for your clients. Because of the status of your profession, the results of this survey can reasonably be expected to impact on the decision-making process.

I would greatly appreciate it if you would complete the enclosed questionnaire (which has been specially designed to take you no longer than 30 minutes to complete), and return it in the enclosed return-addressed postage-paid envelope at your earliest convenience, but no later than 20 November 2002.

Should you have any queries please do not hesitate to contact me at wellsm@nu.ac.za.

Thank you.

Yours faithfully

Professor Mike Wells
Associate Professor and Financial Accounting Section Head

SECOND MAILING

28 January 2003

Dear Sir/Madam

SECOND REQUEST: DIFFERENTIAL CORPORATE REPORTING QUESTIONNAIRE

Should you have already responded to this questionnaire kindly ignore this letter. I have as yet not received your completed questionnaire that was mailed to you on 4 November 2002. In the hope of obtaining your input on this important accounting issue I have enclosed a second copy of the questionnaire. I would greatly appreciate it if you would complete the enclosed questionnaire (which has been specially designed to take you no longer than 30 minutes to complete), and return it in the enclosed return-addressed postage-paid envelope at your earliest convenience, but no later than 15 February 2003.

As a Registered Accountant and Auditor, you are probably aware that current draft legislation proposes differential corporate reporting for limited purpose financial statements of South African private companies. However, the form, content and basis of preparation of such limited purpose financial statements are yet to be decided upon, and little South African research into differential reporting has been conducted.

The purpose of this research questionnaire (being carried out in partial fulfilment of a Masters of Accountancy degree) is to provide the scientifically researched view of South African Registered Accountants and Auditors into the differential corporate reporting decision-making process. A good response to this questionnaire is vital. As a Registered Accountant and Auditor, you have the requisite knowledge of South African Statements of Generally Accepted Accounting Practice to meaningfully complete this questionnaire, and understand the implications of differential corporate reporting for your clients. Because of the status of your profession, the results of this survey can reasonably be expected to impact on the decision-making process.

Should you have any queries please do not hesitate to contact me at wellsm@nu.ac.za.

Thank you.

Yours faithfully

Professor Mike Wells
Associate Professor and Financial Accounting Section Head

APPENDIX B

QUESTIONNAIRE

For the purpose of this questionnaire *differential corporate reporting* relates to the imposition of different statutory reporting requirements for different categories of corporate entities.

PART 1: DEMOGRAPHICS

1. Which category best describes the number of years that you have been registered with the Public Accountants' and Auditors' Board?
(Please tick one)

Less than 5 years ☐ 5 to 10 years ☐ 11 to 20 years ☐ More than 20 years ☐

2. Which category best describes the size of your practice?
(Please tick one)

Large multinational (i.e. 'final four' + BDO + GTKF + etc) ☐
Large (multiple JSE Securities Exchange listed audit clients) ☐
Medium ☐
Small ☐

PART 2: THE NEED FOR DIFFERENTIAL REPORTING

3. Do you perceive a need for differential corporate reporting requirements in South Africa?
(Please tick one)

YES	NO

4. Briefly support your answer to question 3.

PART 3: THE FORM OF DIFFERENTIAL REPORTING

5. How do you rate the suitability of each of the following possible forms of differential reporting for the limited purpose financial statements of a private company whose financial statements are only distributed to its shareholders and attached to its IT14 tax return?
(Please circle only one number for each of a, b, c, d, e & f below)

		Very unsuit-able	Unsuit-able	Indiff-erent	Suit-able	Very suit-able
a.	The income tax basis (i.e. in accordance with tax law).	1	2	3	4	5
b.	The cash basis (i.e. record cash transactions only).	1	2	3	4	5
c.	Unlimited deviations from SA GAAP (i.e. The private company devises its own accounting policies without reference to SA GAAP).	1	2	3	4	5
d.	Limited formalised deviations from SA GAAP (i.e. Each SA Statement of GAAP specifies exemptions from specific provisions).	1	2	3	4	5
e.	Completely separate set of SA GAAP for limited purpose financial statements	1	2	3	4	5
f.	Other (specify)	1	2	3	4	5

6. How do you rate the suitability of each of the following possible forms of differential reporting for the limited purpose financial statements of a private company whose financial statements are used by its shareholders, its bankers and other financiers, its franchisor, SARS, other government agencies, etc?
(Please circle only one number for each of a, b, c, d, e & f below)

		Very unsuit-able	Unsuit-able	Indiff-erent	Suit-able	Very suit-able
a.	The income tax basis (i.e. in accordance with tax law).	1	2	3	4	5
b.	The cash basis (i.e. record cash transactions only).	1	2	3	4	5
c.	Unlimited deviations from SA GAAP (i.e. The private company devises its own accounting policies without reference to SA GAAP).	1	2	3	4	5
d.	Limited formalised deviations from SA GAAP (i.e. Each SA Statement of GAAP specifies exemptions from specific provisions).	1	2	3	4	5
e.	Completely separate set of SA GAAP for limited purpose financial statements.	1	2	3	4	5
f.	Other (specify)	1	2	3	4	5

PART 4: THE CONTENT OF DIFFERENTIAL REPORTING

The questions that follow in Part 4 apply to the following twelve hypothetical businesses:

A: JSE Securities Exchange listed company with an annual turnover of R3 000 million (Hereinafter: Big JSE listed).

B: JSE Securities Exchange listed company with an annual turnover of R60 million (Hereinafter: Small JSE listed).

C: Public company that is not listed on the JSE Securities Exchange with an annual turnover of R3 000 million (Hereinafter: Big public unlisted).

D: Public company that is not listed on the JSE Securities Exchange with an annual turnover of R60 million (Hereinafter: Small public unlisted).

E: Private company with an annual turnover of R300 million whose financial statements are made available only to its shareholders and attached to its IT14 tax return (Hereinafter: Big private no users).

F: Private company with an annual turnover of R300 million whose annual financial statements are widely distributed to various users including: its shareholders, its bankers and other financiers, its franchisor, SARS, other government agencies, etc (Hereinafter: Big private with users).

G: Private company with an annual turnover of R600 000 whose financial statements are made available only to its shareholders and attached to its IT14 tax return (Hereinafter: Small private no users).

H: Private company with an annual turnover of R600 000 whose annual financial statements are widely distributed to various users including: its shareholders, its bankers and other financiers, its franchisor, SARS, other government agencies, etc (Hereinafter: Small private with users).

I: Close corporation with an annual turnover of R300 million whose financial statements are made available only to its members and attached to its IT14 tax return (Hereinafter: Big CC no users).

J: Close corporation with an annual turnover of R300 million whose annual financial statements are widely distributed to various users including: its members, its bankers and other financiers, its franchisor, SARS, other government agencies, etc (Hereinafter: Big CC with users).

K: Close corporation with an annual turnover of R600 000 whose financial statements are made available only to its members and attached to its IT14 tax return (Hereinafter: Small CC no users).

L: Close corporation with an annual turnover of R600 000 whose annual financial statements are widely distributed to various users including: its members, its bankers and other financiers, its franchisor, SARS, other government agencies, etc (Hereinafter: Small CC with users).

7. **Presentation and disclosure** *(Note: question 8 deals with recognition and measurement)*

For each of the twelve hypothetical entities listed above, in respect of each Statement of Generally Accepted Accounting Practice listed below, indicate whether or not you consider its presentation and disclosure requirements to be:

- appropriate *(mark with "A"),*
- inappropriate *(mark with "I"), or*
- if you are undecided *(mark with "U").*

For example if you consider the presentation and disclosure requirements of AC 102 (Income taxes) to be appropriate to entities A, B, C, D, E, F, I & J but inappropriate to entities G & H and you were undecided with respect to entities K & L, you would complete 7.1 as follows:

		A Big JSE listed	*B Small JSE listed*	*C Big public unlisted*	*D Small public unlisted*	*E Big private no users*	*F Big private with users*	*G Small private no users*	*H Small private with users*	*I Big CC no users*	*J Big CC with users*	*K Small CC no users*	*L Small CC with users*
7.1	*AC 102: Income taxes*	*A*	*A*	*A*	*A*	*A*	*A*	*I*	*I*	*A*	*A*	*U*	*U*

		A Big JSE listed	**B Small JSE listed**	**C Big public unlisted**	**D Small public unlisted**	**E Big private no users**	**F Big private with users**	**G Small private no users**	**H Small private with users**	**I Big CC no users**	**J Big CC with users**	**K Small CC no users**	**L Small CC with users**
7.1	AC 102: Income taxes												
7.2	AC 105: Leases												
7.3	AC 108: Inventory												
7.4	AC 112: Foreign currencies												
7.5	AC 116: Employee benefits												
7.6	AC 123: Property, plant & equipment												
7.7	AC 125 & AC 133: Financial instruments												
7.8	AC 128: Impairment of assets												
7.9	AC 129: Intangibles												
7.10	AC 130: Provisions												
7.11	AC 135: Investment properties												
7.12	AC 137: Agriculture												

8. **Recognition and measurement** *(Note: question 7 deals with presentation and disclosure)*

For each of the twelve hypothetical entities listed above, in respect of each Statement of Generally Accepted Accounting Practice listed below, indicate whether or not you consider its recognition and measurement requirements to be:

- appropriate *(mark with "A"),*
- inappropriate *(mark with "I"), or*
- if you are undecided *(mark with "U").*

		A Big JSE listed	B Small JSE listed	C Big public unlisted	D Small public unlisted	E Big private no users	F Big private with users	G Small private no users	H Small private with users	I Big CC no users	J Big CC with users	K Small CC no users	L Small CC with users
8.1	AC 102: Income taxes												
8.2	AC 105: Leases												
8.3	AC 108: Inventory												
8.4	AC 112: Foreign currencies												
8.5	AC 116: Employee benefits												
8.6	AC 123: Property, plant & equipment												
8.7	AC 125 & AC 133: Financial instruments												
8.8	AC 128: Impairment of assets												
8.9	AC 129: Intangibles												
8.10	AC 130: Provisions												
8.11	AC 135: Investment properties												
8.12	AC 137: Agriculture												

9. For each of the twelve hypothetical **entities listed above, indicate** whether or not you consider the AC 118 requirement to present a cash flow statement to be:
   - appropriate *(mark with "A")*,
   - inappropriate *(mark with "I")*, *or*
   - if you are undecided *(mark with "U")*.

	A Big JSE listed	B Small JSE listed	C Big public unlisted	D Small public unlisted	E Big private no users	F Big private with users	G Small private no users	H Small private with users	I Big CC no users	J Big CC with users	K Small CC no users	L Small CC with users
AC 118: Cash flow statements												

10. For each of the twelve hypothetical entities listed above, indicate whether or not you consider the AC 126 requirement to present related party disclosures to be:
   - appropriate *(mark with "A")*,
   - inappropriate *(mark with "I")*, *or*
   - if you are undecided *(mark with "U")*.

	A Big JSE listed	B Small JSE listed	C Big public unlisted	D Small public unlisted	E Big private no users	F Big private with users	G Small private no users	H Small private with users	I Big CC no users	J Big CC with users	K Small CC no users	L Small CC with users
AC 126: Related party disclosures												

11. Assume that the reporting entity has significant subsidiaries. For each of the twelve hypothetical entities listed above, indicate whether or not you consider the AC 132 requirement to prepare consolidated financial statements to be:
   - appropriate *(mark with "A")*,
   - inappropriate *(mark with "I")*, *or*
   - if you are undecided *(mark with "U")*.

	A Big JSE listed	B Small JSE listed	C Big public unlisted	D Small public unlisted	E Big private no users	F Big private with users	G Small private no users	H Small private with users	I Big CC no users	J Big CC with users	K Small CC no users	L Small CC with users
AC 132: Consolidated financial statements												

APPENDIX C

REASONS FOR AND AGAINST DIFFERENTIAL REPORTING CITED BY RESPONDENTS

1. Reasons cited by respondents in support of differential corporate reporting

"The value of a full report for small family type companies is not only ridiculous, but cost ineffective."

"While full GAAP is necessary and appropriate for large companies in which the public has an interest, it if far too complex and often irrelevant for private businesses. Business decisions are often taken on a basis very different from GAAP requirements, eg a trading company usually sets its selling price of goods based on the forward cover rate obtained for purchases. It would make sense for that entity to account in that way too. The costs of GAAP compliance are prohibitive to smaller businesses."

"With the multitude of new statements, there is a definite need for 'small GAAP' which would apply mainly to the owner managed (Pty) company."

"Existing statutory requirements are too cumbersome for small companies."

"My client base consists of mainly: owner operated and controlled companies and close corporations; sole traders; and taxation clients. Their annual financial statements are used only by their bankers and tax authorities. The clients have no need for, nor do they comprehend statements conforming to the requirements of GAAP."

"Proper compliance with 'big' GAAP is too onerous for small companies with limited accounting and financial resources."

"Particularly GAAP is designed exclusively for large and quoted companies."

"Small private companies simply do not have the staff and resources to meaningfully apply the principles and disciplines required by generally accepted accounting practices. The people running a small to medium size business generally do not fully understand the basic principles of GAAP and simply have no need for it."

"Owner managed business benefits little from the disclosure requirements of 'new' GAAP which increases costs of record keeping and also the audit fee."

"Members of the public (either direct or via pension funds, life insurance, etc.) invest in quoted corporations and need an independent assessment of the management of these corporations. Private companies/close corporations are mostly owner run and so are aware of the state of affairs on a day to day basis – and it should not be an auditor's responsibility to protect them from their own folly (poor internal control etc.)."

"International GAAP has no relevance to the users of small businesses being owners (entrepreneurs) and their bankers."

"The imposition of GAAP in many instances is onerous given the non JSE listed, environment where imposition of requirements is neither of substantial benefit nor use to the company or the users of its financial statements. Reference is particularly to family or independently owned private companies that have no reporting requirements to the general public and only fairly specific users *inter alia* banks/creditors/finance houses etc."

"The financial statements produced for owner operated private companies are for personal use, banks and SARS. The cost involved to comply with all the GAAP requirements is not cost effective and is of no use to the owners. In most cases, they do not even understand it."

"With limited users, the cost of complying to GAAP outweighs the benefit derived therefrom."

"I believe that differential reporting MUST be based on users of AFS and NOT on turnover or any size measurement. Most of my AFS are prepared for the director, SARS, and the bank manager."

"Different clients need different report, especially the small client that only has a (Pty) Ltd for its property so that a trust is a shareholder because just natural persons can have an interest in a close corporation. These types of (Pty) Ltd is not formal, it is merely formality."

"One size fits all is not appropriate. Certain GAAP requirements suitable for large listed companies add little or no value to the AFS of small owner managed businesses."

"There are 3 tiers to be considered, namely: 1) large listed entities and entities that report extensively to third parties who have little or no access to request further information – FULL STANDARDS 2) entities where all parties agree to a reduced disclosure and the overriding principle is cost in preparing the AFS 3) entities which prepare their AFS for tax purposes as a requirement of the tax act and thus should be entitled to report in terms of the tax act – this would be the owner managed business who has incorporated. All 3 of these require different levels of disclosure."

"Formalised deviations from GAAP for private companies and close corporations."

"The reporting requirements for private companies are onerous and no benefit is achieved for the users of these financial statements."

"1) Listed companies – protect public interest and 2) Small managed owned companies – resources/knowledge a problem. Financial statements distributed to shareholders."

"Due to the amount of small businesses a more suitable reporting format would be feasible."

"Small company financials should be prepared for the information of users viz: Receiver of Revenue, banks and shareholders and financiers whereas large company financials need to cater for investors. Small company shareholders are not normally interested in accounting policies and normally have their financials prepared mainly for the use of the Receiver of Revenue and their bankers. They are normally unsophisticated and use the corporate entity as a shield against creditors."

"Need to keep business simple for small companies an close corporations."

"1) Users – small companies' only Receiver of Revenue and Bank. 2) Big GAAP becoming so comprehensive and costly."

"Reporting requirements for smaller companies are onerous and does not provide any benefits in relation to costs."

In certain instance financial statements are prepared for the shareholder or member only and for tax. I believe that, at least the presentation and disclosure requirements should be different for a small enterprise, e.g. such as segment reporting is required only for listed companies, the same

should apply to other like AC133, etc. The cost of preparing such information adds no value to the user."

"Makes practical sense and also economically practical. My knowledge of GAAP requirements is poor. I need to do plenty of studying!"

"1) Users of close corporation/private companies' tend to be limited to a small number of stakeholders/bank/ and Receiver of Revenue. 2) It is very costly to produce compliant AFS for private companies with say 1 or 2 shareholders. 3) Detailed disclosures add very little value to the shareholders and in my experience tend to confuse the revenue! 4) Smaller companies are 'tax focussed' and want their income statement profit to be the amount they pay tax on, ie simplicity. 5) In my experience, very few clients (even finance people who are CA's!) tend to derive benefit from the detailed disclosures."

"Smaller companies don't need the requirements as they usually only have one or two shareholders who will never need the full reporting requirements."

"Reporting to private companies shareholders versus reporting to public companies investors."

"We got mostly small to medium businesses, which are owner managed and control. The requirements from relevant individuals differ from listed companies and there is a big resistance to fees."

"1) GAAP often not appropriate for the small business, specifically one which is owner managed. 2) Cost of complying is disproportionate to the benefits accruing to the owner/user. 3) Owners resent having to pay for something which they see no benefit.4) Standards required by GAAP not understood by owners/users. 5) For the economy as a whole GAAP applied to smaller entities represents wasted costs and leads to incompetitiveness."

"1) From a point of view of third party exposure to risk as concerns small enterprises, ie no large investments by persons other than owners, I think reporting requirements should be more relaxed. 2) Also usage of financial statements of small/micro businesses – very limited therefore no need for very onerous reporting requirements 3) Cost/benefit analysis dictates simpler requirements ito reporting and or preparation of financial statements."

"Small companies and close corporations do not necessarily require same reporting standards as large listed companies. The costs involved in reaching this standard are not justified or necessary."

"Most small businesses have neither the need nor the infrastructure to cater for some of the reporting requirements. They have no need to incur additional costs to meet these requirements. The users of their financial statements are limited to themselves, their bankers and the revenue services, none of whom require the information called for."

"The readers and users of financial statements are completely different between large and small Pty's. The cost is not justifiable for the small Pty."

"Present requirements onerous for non listed and (Pty) Ltd businesses as well as all close corporations."

"Many of our small proprietary companies cannot afford the cost of complying with the requirements of SA Statements of GAAP. In any event, the users of these statements are generally limited."

"In small enterprises we find the following: 1) interest parties are 1.1) The owner ie shareholder in the company who knows his business 1.2) The banker who has access to any information he requires 1.3) The revenue authorities who also have access to additional information and are not interested in theoretical projections. 2) No value is added by lengthy reports on historical matters. 3) Clients resist fees which arise as a result of detailed reports."

"The majority of 'small' companies (managed/owned companies) do not require all the reporting requisites and / or do not generally encompass all the different 'businesses' which currently require disclosure."

"A lot of time is spent getting clients' financial statements to comply 100% with GAAP, without there being any real benefit to the clients. Different standards for private companies would also hopefully result in lower audit fees for clients, but still meet the necessary disclosure requirements."

"Owner controlled. You do not need a sledge hammer to kill a mosquito."

"Many of the reporting requirements have no relevance to the users/shareholders and only serve to increase the complexity of reporting and to increase the costs of accounting and auditing."

"Disclosure requirements applicable to large corporations with public shareholders and 'professional'management. (ie salaried) does not apply to the same extent to smaller owner managed companies where shareholders and mangers are to a large extent the same. The disclosure requirements often require additional accounting systems and or skill and this has a major impact on the audit cost. We find that private companies are unwilling to pay for complicated disclosure requirements which does not add value to their businesses."

"It is ludicrous to expect small clients to pay for reporting that is beyond their comprehension and which is of no value to them. Auditors spend half the audit fee preparing the necessary disclosure which neither the client, bank manager nor Receiver of Revenue looks at never mind understands. I accept that for big companies with many shareholders who opt for full reporting and listed companies the disclosure is necessary."

"It is not feasible for the small private companies to try to comply with all these requirements. The value for the small company is often nil, and the process to adhere to these requirements cost a lot. The users of the financial statements of the small companies do not need all the information that the investor in the large multi-national operation requires."

"Extensive reporting requirements should exist for listed and public companies. The reporting requirements of private companies can be limited depending on the involvement of the shareholders in the management of the company. In the case of many private companies the shareholders are actively involved in the management of the company."

"The disclosure requirements are not in my opinion necessary in all instances in the case of small companies."

"User focus. Listed companies and others that accept deposits from public should report under IFRS. General purpose financial statements are appropriate for companies who deal with the public – eg accept deposits from public eg issue shares to general public. The cost benefit consideration often gives a different answer where there are limited uses. I support less onerous reporting requirements, via targeted adjustments to IFRS, provided all members approve – approval should be annual. The less onerous requirements must consider minority shareholders, SARS and the Banks."

"1) I believe that the financial statements of certain companies have a limited and very specific user namely 1. The providers of finance; 2. The SARS. 2) We need to as a profession encourage such things as asset protection and this can mainly be done in setting up companies. Currently most of us are trying to get away from auditing companies. 3) Current legislation is certainly not encouraging small business development."

"Not practical or cost effective for small companies to comply with all GAAP requirements. Owner owned businesses do not always require the full audit function."

"Small businesses with one shareholder/member do not have the need nor the cash flows to support corporate requirements."

"1) It is expensive for clients to give a full report. 2) Small companies do not understand and need a full report – shareholders and directors do not always understand the detail. 3) When GAAP adherence reporting was introduced, the average fees for a small company doubled."

"GAAP is a wonderful tool to ensure transparent and consistent disclosures for big, listed and multi-national organisations. For the 'owner-run' companies, it is an unnecessary burden to comply with these internationally aligned policies. Shareholders of private companies are only concerned about 2 things: 1) how much profit did the company make? 2) How much tax must the company pay? Various GAAP statements, eg AC130 is in 'direct opposition to them determining their real profit – so you have to ask yourself – what is the point to burden these companies with these inflexible requirements set by GAAP?"

"Immensely problematic GAAP vs gaap but practically costs and skills and usefulness make differential reporting essential."

"1) No practical use to many small users/owners 2) Far too much detail for needs of users/owners and third party banks/Receiver of Revenue."

"1) Complexity of new standards translated into large cost for 'private' companies. 2) Users of 'private' company financials do not need all the technical/fancy information."

"The requirements of the owner managed businesses are totally different from listed companies. It also is expensive for an owner managed business to adhere to the requirements of a listed company."

2. Reasons cited by respondents opposed to differential corporate reporting

"Could be useful to have but not really necessary."

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