

# Financial reporting in entrepreneurial SMEs

In search of significant areas of  
financial reporting information

ANNIKA YSTRÖM

Licentiate thesis in Business Administration



JÖNKÖPING INTERNATIONAL  
BUSINESS SCHOOL

JÖNKÖPING UNIVERSITY

Jönköping International Business School  
P.O. Box 1026  
SE-551 11 Jönköping  
Sweden  
Tel. + 46 36 15 77 00  
E-mail: [info@jibs.hj.se](mailto:info@jibs.hj.se)  
[www.jibs.se](http://www.jibs.se)

*Financial reporting in entrepreneurial SMEs: In search of significant areas of financial reporting information*  
JIBS Research Report Series No. 2010-3  
Licentiate thesis in Business Administration

© 2010 Annika Yström and Jönköping International Business School Ltd.

ISSN 1403-0462  
ISBN 978-91-86345-09-9

Printed by Ark Tryckaren AB

## Acknowledgements

During the long and winding process of writing this thesis I have received the most valuable support and encouragement from a number of people to whom I wish to acknowledge my heartfelt gratitude.

First, I would like to express my sincere appreciation to my main supervisor, Olov Olson, who has been a constant source of inspiration by his wide knowledge and pragmatic approach to accounting research. Olov has had a great sense of helping me stay focused and providing encouragement when most needed. I am also very grateful to Olov for inviting me as an associated member to the research programme *Accounting in an entrepreneurial context*.

I would also like to express my sincere appreciation to my assistant supervisor, Emilia Florin Samuelsson. Emilia's engagement actually started long before she became my formal supervisor. Thank you, Emilia, for your constant support and encouragement, and for reading through a number of drafts of my thesis and providing your very valuable and concrete advice.

I am genuinely grateful to Fredrik Ljungdahl, Marita Blomkvist and Fredrik Lundell for providing me with many helpful comments during internal seminars at Jönköping International Business School (JIBS). Thanks also to all members of the research programme *Accounting in an entrepreneurial context* for providing me with valuable comments during seminars and conferences.

My sincere thanks to the accounting experts, Caisa Drefeldt, Hans Edenhammar, Robin Jarvis, Paul Pacter, Bengt Skough, Per Thorell and Bo Åsell, for generously dedicating their time, sharing knowledge and showing interest in my research project.

Thanks also to all my colleagues and friends, present and former, at JIBS, for their support and joyous acclamations, and for making me looking forward to my work every day. My special thanks to Fredrik Lundell who has always been encouraging and eager to discuss my ideas.

I am also grateful to Björn Kjellander who helped me improve the language of my thesis, and Susanne Hansson who assisted with the final editing.

Finally, I would like to thank my family and friends for all your love and support. Special thanks to my mum, my brother and Jörgen.

Jönköping, 2010-04-15

Annika Yström



## Abstract

This study sets out from the contemporary discussion on the need of separate financial reporting standards for small and medium-sized enterprises (SMEs), and focuses on financial reporting information needs in the context of entrepreneurial and growth-oriented SMEs. The main purpose of the study is to *sort out areas of financial reporting information that are likely to be of significance to managers of entrepreneurial SMEs in their provision of information to users*. In order to fulfill this purpose data has been collected in several sequential steps where the results of each step have provided with significant input and structure to the carrying through of the following step/s. The first step consists of a literature study of previous empirical studies about accounting information in entrepreneurial contexts. In the second step, interviews have been conducted with accounting experts engaged in the current discussion on the development of accounting standards for SMEs. The third and fourth step consists of document studies of comment letters to the Swedish standard setter *Bokföringsnämnden's* (BFN) two drafts of the accounting standard *Financial reporting in small companies (K2)* and IASB's *Exposure draft of an IFRS for SMEs*.

According to the study results the continuous high demand for financial capital is a great challenge to managers of entrepreneurial SMEs in their efforts to make their entities develop and grow. In this context, financial reports make up an important tool mainly for informing external capital providers, among which bankers are considered to hold a prominent position. The high demand for financial capital also makes risk capitalists and other external owners more important as financiers of entrepreneurial SMEs than what is the case in SMEs in general. Other important users of entrepreneurial SMEs' financial reports are customers, suppliers, employees, potential acquirers and management.

One of the areas of financial reporting information that have been sorted out in this study as likely to be of significance to managers of entrepreneurial SMEs in their provision of information to users is *cash flow*. Information on cash flow is likely to be significant in the entrepreneurial context not at least since the development of entrepreneurial activities puts a lot of pressure on managers to secure the continuous inflow of cash. The extent to which capital providers make use of cash flow information provides with further argument for its importance in the entrepreneurial context. Also, entrepreneurial entities tend to rely on intangible assets to a high extent, and these assets are in general not sufficiently reflected in the balance sheets. Cash flow provides in this respect straightforward and reliable complementary information that is important when assessing the prospects of the business.

Besides information on cash flow, information on *intangible assets* is according to the results of this study likely to be significant in an entrepreneurial context. The possibility to capitalize expenses for intangible investments is crucial not at least to avoid the legal consequences of bankruptcy law, which may be critical to the very survival of development-intensive entrepreneurial SMEs. The importance of innovation as a central part of the entrepreneurial process also makes financial reporting information on intangibles highly relevant from an informational perspective.

In addition, financial ratios in general, and financial ratios measuring various aspects of growth - i.e. *growth ratios* - in specific, have been sorted out as likely to be of specific importance to include in the financial reports of entrepreneurial SMEs. Besides disclosure of additional information on individual intangible assets, *additional disclosure* of information related to the collective earning capacity of ongoing projects - including the business concept of the reporting entity - has also been identified as significant in the entrepreneurial context.

# Contents

1	Introduction .....	11
1.1	The contemporary discussion on financial reporting and SMEs...	11
1.2	Accounting in the context of entrepreneurial SMEs .....	13
1.3	Purpose of the study .....	14
1.4	Overall design of the study.....	15
2	Frame of reference.....	19
2.1	Financial accounting: Purposes, users and usefulness.....	19
2.1.1	Usefulness: Qualitative characteristics of financial reports ..	22
2.1.2	Underlying assumptions .....	24
2.2	Financial reporting in the SME context.....	24
2.2.1	Financial reporting and SMEs in the academic literature.....	25
2.2.2	Financial reporting and SMEs according to standard setters.....	27
2.2.3	Implications for this study.....	30
2.3	Entrepreneurship .....	32
2.3.1	Entrepreneurship and growth.....	33
2.3.2	Growth and the demand for financial resources .....	34
2.3.3	Implications for this study.....	34
3	Literature study of previous empirical studies of accounting in entrepreneurial contexts .....	37
3.1	Mode of procedure .....	37
3.2	Results of the literature study .....	38
3.3	Summary of the results of the literature study .....	42
4	Interviews with accounting experts.....	45
4.1	Mode of procedure .....	45
4.1.1	Choice of respondents .....	45
4.1.2	The interviews .....	48
4.1.3	Processing, interpreting and presenting the interview data.....	49
4.2	Results of the interviews with accounting experts.....	50
4.2.1	Users and purposes of financial reports in the context of entrepreneurial SMEs.....	50

4.2.2	Financial reporting information of certain importance in an entrepreneurial context .....	55
5	Document study of comment letters to <i>BFN's</i> K2 drafts .....	65
5.1	Mode of procedure .....	65
5.2	Results of the document study.....	66
5.2.1	The need to set up a balance sheet for liquidation purposes .....	69
5.2.2	Increased administrative burden and restructuring of development projects.....	69
5.2.3	Less relevant information to users of financial reports.....	70
5.2.4	Prevention of development projects .....	71
5.2.5	Summary of results .....	72
6	Document study of comment letters to the IASB draft <i>IFRS for SMEs</i> 73	
6.1	Mode of procedure .....	74
6.2	Results of the document study.....	76
6.2.1	Comments on entrepreneurship, innovation and growth....	76
6.2.2	Comments on cash flow statements .....	77
6.2.3	Comments research and development (R&D) and other intangible assets .....	81
6.2.4	Summary of results .....	82
7	Comparative analysis .....	85
7.1	Users and purposes in the context of entrepreneurial SMEs.....	85
7.2	Financial reporting information of specific importance in an entrepreneurial context.....	87
7.2.1	Information on cash flow.....	88
7.2.2	Information on intangible assets .....	90
7.2.3	Financial ratios and other additional disclosure .....	92
8	Conclusions and further research .....	95
8.1	Conclusions of the study .....	95
8.1.1	Users and purposes in the context of entrepreneurial SMEs .....	95
8.1.2	Significant areas of financial reporting information in an entrepreneurial context.....	96

8.2	Suggestions of further research on financial reporting in the context of entrepreneurial SMEs .....	97
	References .....	101
	Appendix 1: Possible respondents for the interviews with accounting experts.....	107
	Appendix 2: Interview questions .....	109
	Appendix 3: Respondents to <i>BFN's</i> K2 drafts .....	110
	Appendix 4: Respondents to the draft <i>IFRS for SMEs</i> .....	111
	JIBS Research Reports.....	115

## Figure

Figure 1.1	Overall design of the study .....	17
------------	-----------------------------------	----

## Tables

Table 3.1	Important items of accounting information in an entrepreneurial context according to previous empirical studies.....	43
Table 4.1	Accounting experts interviewed .....	47
Table 4.2	Users of entrepreneurial SMEs' financial reports.....	54
Table 4.3	Significant areas of financial reporting information according to the interviewed accounting experts .....	63
Table 5.1	Arguments against the suggested K2 regulation concerning internally generated intangibles.....	68
Table 6.1	Occurrences of search words in the comment letters to the draft <i>IFRS for SMEs</i> .....	75
Table 6.2	– Comment letters providing support for a mandatory cash flow statement .....	78
Table 6.3	Comment letters providing the view that the cash flow statement should <i>not</i> be mandatory for SMEs .....	80
Table 7.1	Financial reporting information of specific importance in an entrepreneurial context .....	88



# I Introduction

## I.1 The contemporary discussion on financial reporting and SMEs

During the past few decades, the accounting literature has looked more closely into whether smaller non-public companies should be held accountable according to the same financial reporting standards as large and/or public companies (e.g. Evans & di Pietra et al., 2005; Jarvis, 1996; Keasey and Short, 1990). This issue has engaged practitioners and researchers as well as standard setting institutions and has led to that several jurisdictions have developed, or are in the process of developing, differential reporting systems for SMEs (small and medium-sized enterprises). In the United States, for instance, the FASB<sup>1</sup> in 1996 issued Statement No. 126, Exemption from Certain Required Disclosures about Financial Instruments for Certain Non-public Entities, and subsequently, in 1997, the UK standard setting body ASB published the Financial Reporting Standard for Smaller Entities, which includes less complicated measurement for some assets and liabilities and a number of exemptions from the otherwise required disclosure. In Sweden, a differential reporting system is applied in the sense that non-public enterprises can choose either to apply the IAS/IFRS-based standards issued by *Redovisningsrådet*, or the simplifications offered by *Bokföringsnämnden's* general advice. Since the current differential reporting system, which has been in use since 1998, has anyhow turned out not only to be too complicated, but also to result in financial statements that are too difficult for users to interpret (BFN, 2004a), *Bokföringsnämnden* is currently working with the development of a completely new set of differential standards.<sup>2</sup>

On the global arena the issue of financial reporting and SMEs has been attended to by the International Accounting Standards Board (IASB), who included a research project on the agenda in 2002 with the aim of reducing the financial reporting burden on SMEs that want to use global standards (IASB, 2006a). A backward glance at the early project descriptions published on the IASB homepage, however, reveals that there were different opinions put forward during the initial meetings of the project group concerning the issues of who the primary users of SMEs financial reports actually are, and what

---

<sup>1</sup> Financial Accounting Standards Board

<sup>2</sup> A further description of *Bokföringsnämnden's* project is provided in chapter 2 of this thesis.

information these users need. From a topic summary of June 2002 the following statement could be read:

*“It is clear that the users of a small entity’s financial statements may be different, but are their information needs different? If so, do they need less information (the usual presumption) or different and perhaps additional information about the entity?” (IASB, 2002, §12, p. 3)*

In a further updated project summary of June 2003 (IASB, 2003), which reports on a meeting of the SME Advisory Panel held at the IASB offices in April 2003, several statements not in line with the initial project description can be found. Among other things, there was “broad agreement” during the meeting that the users of SMEs’ financial statements are the same as those identified in the IASB *Framework* but with extra weight given to providers of capital and debt (IASB, 2003, §3, p. 1). Contrary to what is “often advanced in among the SME community” management was not put forward as a primary user (IASB, 2003, §3, p. 1). The notes also reveal that there was a broad range of views on the issue of possible alternatives for IASB standards for SMEs. Even so, it seems like the greatest support was for a “simplified” accounting approach and, according to the notes, no specific attention seems to have been directed towards the issue of whether there are demands for *different* and/or *additional* information about SMEs. It is noted, however, that there may be a need for additional work in order to find out what kind of information users actually need (IASB, 2003).<sup>3</sup>

When turning to the academic literature, a few studies can be found suggesting that the main user groups of SMEs financial reports include managers, providers of loan finance, suppliers, employees and the tax authority (Evans et al., 2005; Collis & Jarvis, 2000; Jarvis, 1996). Concerning the information needs of users, however, the literature offers limited guidance. This gap, together with the significance of developing sound accounting standards, implicates that further research is needed on the information needs of users of SMEs financial reports. However, it is not appropriate to talk of SMEs as one homogenous group. Depending among other things upon contextual differences it is likely that the information needs of users of SMEs financial reports will vary between different enterprises belonging to the SME group. For one thing, it is reasonable that the information needs of users of financial reports of entrepreneurial SMEs – where high growth puts high demands on the financial flow from both internal and external sources (Berggren, Lindström & Olofsson, 2001) – are different when compared to established SMEs without

---

<sup>3</sup> On July 9, 2009, the IASB published an *International Financial Reporting Standard for SMEs (IFRS for SMEs)*.

ambitions for growth. This study focuses on information needs of users of financial reports in the context of entrepreneurial SMEs.

## **1.2 Accounting in the context of entrepreneurial SMEs**

Entrepreneurship is today a multidisciplinary field of research engaging academics from a wide variety of disciplines such as economics, geography and sociology. In Sweden, entrepreneurship research has in particular gained ground within the discipline of business administration, and especially in the field of organization theory and strategy (Landström, 2005). There is no single definition of entrepreneurship to be found in the literature but the concept is frequently referred to as having to do with the discovery and exploitation of new business opportunities. The successful exploitation of such opportunities is not only considered to lead to the development and growth of the entrepreneurial entity, but to contribute to the development on the societal level as well.

In spite of the significance of information in the process of discovery and exploitation (Venkataraman, 1997), it is not until recently that academics have started to attend to the use of accounting information in the entrepreneurial context (e.g. Ireland & Webb, 2007; Olson et al., 2003). Bergström and Lumsden's (1993) study on the different factors that have an impact on the use of accounting information systems by managers in small enterprises found that managers with a positive attitude towards growth tended to be higher users of accounting information than managers that were less interested in letting their enterprises grow. Similar results are provided by Johannisson and Löfstål (1995), who conclude that the more entrepreneurial the owner-managers were, the more appreciated were accounting instruments such as budgets, cost accounting, and accounting reports. Further signs that accounting information is of high interest to managers of entrepreneurial entities can be found in a study by Sexton, Upton, Wacholtz & McDougall (1997) investigating the learning needs of growth-oriented entrepreneurs. In the study was found that, among the ten most desired topics where the entrepreneurs perceived a learning need, the highest rated one was how to use cash flow in order to make operational and financial decisions.

The use of accounting information by growth-oriented and entrepreneurial managers is further supported in a number of studies that lately have been carried out in the area of accounting and entrepreneurship (Dergård, 2006; Lundell, 2005; Hansen, 2005). What the studies show in common is that

entrepreneurs use accounting information in the management of on-going operations as well as in entrepreneurial processes. Furthermore, in the two studies reported on in Blomkvist (2008) the statutory financial reports is in focus when inquiring into the extent to which entrepreneurs participate in the production of annual accounts. Blomkvist's qualitative pilot study shows that entrepreneurs are not merely participants in the process of creating annual accounts, but rather highly active in both discussions on how to give accounts in a manner that provides users with "correct" information, and the very procedure of doing so. Blomkvist's quantitative main study compares the participation in the year-end procedures by entrepreneurs managing fast growing firms to the participation of managers of non-growing firms. Entrepreneurs in fast growing firms use and produce formal financial accounting information, and they participate in the year-end procedures to a greater extent than managers of non-growing firms of similar size, leverage and profitability, according to this study.

These studies illustrate the use of and/or engagement in accounting issues by entrepreneurs. Whether the accounting rules that regulate the information contained in the financial reports do lead to the satisfaction of the users' information needs is, however, neither investigated, nor a part of the purposes of the reported studies.

### 1.3 Purpose of the study

This thesis focuses on information needs concerning financial reporting in the context of entrepreneurial SMEs. The main purpose of the study is to *sort out areas of financial reporting information that are likely to be of significance to managers of entrepreneurial SMEs in their provision of information to users*. The point of departure is that managers of entrepreneurial SMEs – in their efforts to make their entities develop and grow - use financial reports in order to inform different actors of the reporting environment of the entity.<sup>4</sup> What constitutes significant financial reporting information in this respect depends on which these actors are, and for what purposes they make use of the financial reporting information. Therefore, in order to fulfill the main purpose of this study, the question of which the main user groups of entrepreneurial SMEs financial

---

<sup>4</sup> What makes up significant information from the perspective of the managers of an enterprise does not necessarily correspond with what is considered to be significant information by other users of the enterprise's financial reports. For instance there might be information that users such as potential investors or competitors find highly desirable but that is not in the management's interest to report on because of the risk of revealing business secrets or for reasons of cost-efficiency (i.e. the cost of reporting outweighs the benefits in terms of the amount of resources invested in the enterprise by users).

## Introduction

reports are, and for what purposes they rely on financial reporting information, will also be addressed.

In this study the concept *entrepreneurial SME* refers to an entity within the SME group managed by growth-oriented individuals who are eager to engage in new development projects and exploit new product areas or markets, in order to take advantage of new business opportunities faster than competitors<sup>5</sup>. In order to make the results of the study as comparable to other studies as possible, the EU definition of SMEs<sup>6</sup> has been chosen for this study.

### 1.4 Overall design of the study

The study presented in this thesis makes up my first exploration into the issues of users and information needs regarding financial reporting in the context of entrepreneurial SMEs. The point of departure for the study is a frame of reference in which the concept of accounting is discussed from the perspective of standard setters and in relation to the accounting literature, in general and in connection to the context of SME's. The frame of reference, which is presented in chapter two of the thesis, also includes a section on the concept of entrepreneurship, its prerequisites and its consequences.

In order to fulfill the purpose of the study data has been collected in several sequential steps where the results of each step have provided significant input and structure to the carrying through of the following step/s. The first step consists of a *literature study* where the focus of the analysis has been on previous empirical studies about the use of accounting information in entrepreneurial contexts. Even if none of the previous studies have been conducted with the aim of sorting out the usefulness of statutory accounting information – which is in focus in this study - they still provide indications of which areas of financial reporting information that should be of specific interest to managers of entrepreneurial SMEs in their provision of information to users. The literature study is presented in chapter three.

In the second step of the study, *interviews* have been carried out with accounting experts engaged in the current on the development of accounting standards for SMEs. The aim of this empirical step, which makes up the main source of data

---

<sup>5</sup> For a further discussion of the term entrepreneurial, see section 2.3.

<sup>6</sup> According to this definition an SME is an enterprise with a maximum number of 249 employees, a maximum turnover of 50 million Euros, and/or a maximum value of total asset of 43 million Euros. In accordance with the EU definition the micro-entities with less than 10 employees are excluded from this study.

for the study, has been to map out the areas of information that accounting experts consider to be crucial to managers of entrepreneurial SMEs in providing information to the users of their entities' financial reports. The respondents who have been chosen for their extensive and documented knowledge and expertise in accounting and regulation issues represent the groups of auditors, academics and standard setters. The mode of procedure as well as results of this empirical step of the study is presented in chapter four.

As a third and fourth step of the study empirical data has been collected by means of *document studies* of comment letters to drafts of accounting standards for SMEs. On the national arena the Swedish standard setter *Bokföringsnämnden (BFN)* has published two drafts of the accounting standard *Financial reporting in small companies (K2)* (BFN, 2006; BFN, 2007) where the first one was submitted for referral in early 2006 and the second one, with a few changes, in early 2007. With reference to the international context, the IASB presently published an *IFRS for SMEs* and during the development work an Exposure draft of the coming accounting standard was published for comment in February 2007. In chapter five of this thesis the document study of the comment letters to the two *BFN* drafts is presented and, thereafter, chapter six presents the document study of the comment letters to the draft *IFRS for SMEs* (IASB, 2007a).

Figure 1.1 below illustrates the sequential design of the study where the different steps are guided by the results of the previous step/steps, with the frame of reference as a point of departure. As a final step of the study, a comparative analysis is carried out with focus on the similarities and differences between the results of the different steps, concerning users and information needs in the context of entrepreneurial SMEs. The comparative analysis is presented in chapter seven, and thereafter, in chapter eight, the overall conclusions of the study and some suggestions for further research are presented.

*Introduction*

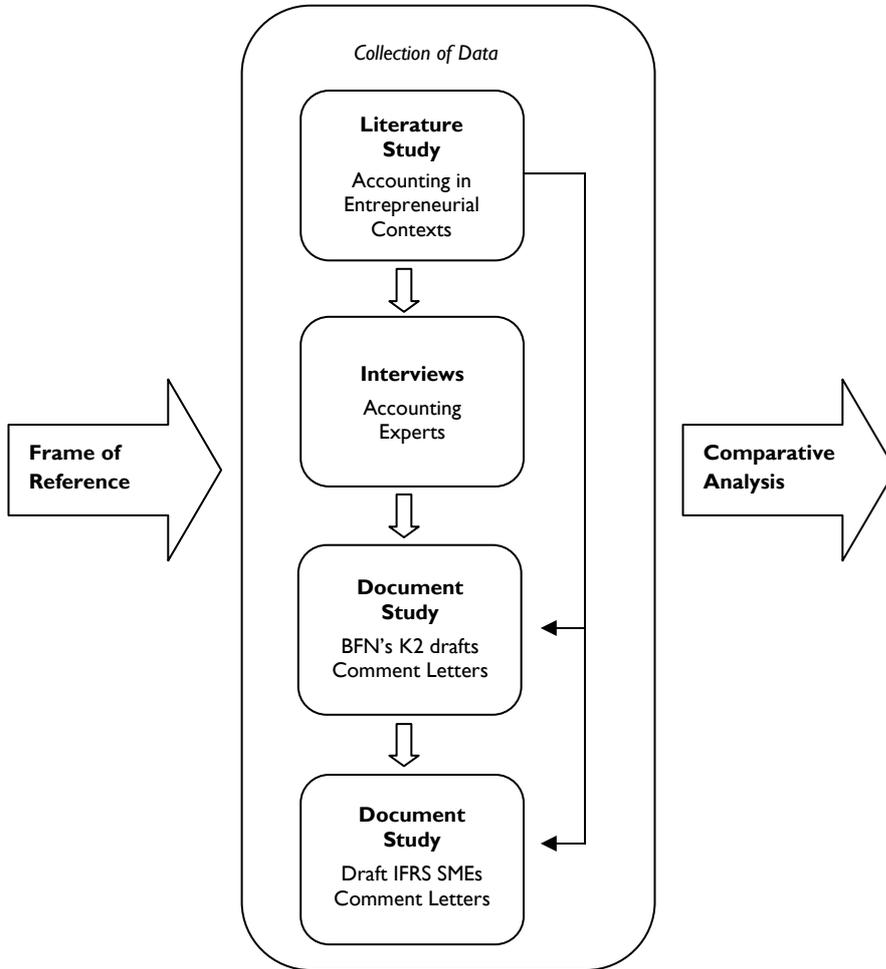


Figure 1.1 Overall design of the study



## 2 Frame of reference

This chapter presents the frame of reference that has provided the point of departure for the different steps of data collection carried out in this study. Section 2.1 starts with a presentation of the general purposes of financial accounting as expressed in the accounting literature and by standard setters, and also the criteria that financial accounting should fulfill in order to meet its purposes. Thereafter, in section 2.2, financial accounting is connected to the context of privately-held SMEs, according to the academic literature as well as according to the accounting regulation. The final section of the chapter, section 2.3, deals with the concept of entrepreneurship, its prerequisites and consequences. Both section 2.2 and 2.3 are concluded by a discussion of how the different parts of the frame of reference have guided the fulfillment of the present study.

### 2.1 Financial accounting: Purposes, users and usefulness<sup>7</sup>

Even though it has not been possible to agree on the main objectives of financial accounting (e.g. Artsberg, 2003; Alexander & Nobes, 2001; Hendriksen & Van Breda, 1992) the discussions in the literature mainly center on the two tasks of stewardship-control/accountability and provision of information for economic decision-making. The stewardship-control function refers to the way in which accounts should provide information about the management of resource-use (Mellemvik et al., 1988). Traditionally the stewardship-control objective referred to the separation of ownership and control with emphasis on the way in which financial statements demonstrated to the shareholders that the resources entrusted to management had been used in a proper way (Mathews & Perera, 1996). Successively, however, a much wider group of stakeholders came to hold enterprises accountable for actions taken in various market places for capital, products, services and labor, and also for actions with environmental consequences. Consequently, financial reports came to serve as a means for stewardship control not only for shareholders but also for creditors, employees, suppliers, customers, government agencies and society at large (ASSC, 1975, in Mathews & Perera, 1996).

According to the decision-making objective, which is a more recent approach to the use of financial statements (Mathews & Perera, 1996; Petersohn, 1995;

---

<sup>7</sup> In this thesis the concepts *financial accounting* and *financial reporting* are used as synonyms with reference to accounting information that is included in the statutory financial reports of an entity.

Kam, 1990), the accounting reports should provide information useful for economic decision-making. Such a view implies a future-oriented perspective where accounting information should assist in guiding the decision-maker in his or her judgment of future performance (Artsberg, 2003). The future-oriented perspective of the decision-making objective does not, however, imply that historical information is of no use since information on past experiences in general plays an important role in assessing the future. Likewise, in assessing the management of resource-use – the stewardship function of accounting – future-oriented information may certainly be beneficial (Artsberg, 2003).

The most important national and international authoritative standard setters - including the FASB and the IASB – give in their frameworks prominence to the decision-making objective as the overall objective of financial information<sup>8</sup>. In the IASB Framework it is made clear that financial reports first and foremost should provide information that is useful to users in their making of economic decisions. Even if it is considered that financial statements also fulfill the stewardship-control function it is anyhow emphasized that “those users who wish to assess the stewardship or accountability of management do so in order that they may make economic decisions” (IASB, 2005).

The lack of consensus as regards the ultimate aim of financial accounting may not seem very surprising when considering the broad range of groups that all may have different views on what purpose accounting should fulfill and what should be its greatest use. Beaver (1998) categorizes the reporting environment of enterprises into five main groups - investors, information intermediaries, standard setters, management and auditors - and calls attention to the circumstance that not only may the way of viewing accounting differ between the different groups, but also that stakeholders within groups are heterogeneous as well. The financial reporting environment should not, however, be confused with the users of enterprises' financial reports since the first mentioned environment do not only include users but embraces all different actors who have a say in and/or are affected by the accounting regulation, including the standard setters themselves. Even if it to a considerable extent still is a debate as concerns who the users of accounting information really are (e.g. Young, 2006), it is frequently suggested that the various groups that are likely to make use of enterprises' financial reports include investors, managers, lenders, employees, suppliers, customers, governments and the public (e.g. Alexander & Nobes, 2001).

---

<sup>8</sup> In the accounting literature, however, criticism can be found against the way not only the IASB, but also the FASB, give prominence to the decision-making objective and fail to pay due attention to the often conflicting stewardship-control function (e.g. Artsberg, 1995; Jönsson, 1988).

### Frame of reference

In the IASB Framework the circumstance that the information needs may differ among users is attended to, but it is also emphasized that all of the information needs of the different users cannot be met by financial statements. Even so it is stated that there are information needs which are common to all users and since “investors are providers of risk capital to the enterprise, the provision of financial statements that meet their needs will also meet most of the needs of other users that financial statements can satisfy” (IASB, 2005: IASB Framework §10, p. 35, IASB, 2005). Accordingly, in their work with developing financial reporting standards the IASB considers investors as the main users of financial statements.

As regards users of financial reports it is notable that in the IASB Framework it is made clear that the primary purpose of financial reporting is *not* to help management in their internal decision-making (Alexander & Nobes, 2001). Such a claim goes hand in hand with the common distinction that traditionally has been made in the accounting literature between *financial accounting* and *management accounting* (Johansson & Östman, 1992). Financial accounting is from such a perspective considered to be concerned with the provision of information to external stakeholders such as creditors and shareholders, while information for internal decision-making is provided by enterprises’ management accounting systems (Anthony & Govindarajan, 1992). The reporting of financial information to external stakeholders, i.e. the financial accounting, is governed by legal rules and norms, while the financial information prepared for internal purposes – the management accounting – is unregulated and voluntary.

The division of the accounting system<sup>9</sup> into financial and management accounting does however not imply that there are distinct boundaries between the two main parts of the system. Rather, it is often suggested that there is a strong connecting link between the two (Johansson & Samuelson, 1998; Johansson & Östman, 1992). Just as well as the accounting information used internally within an enterprise should be of high interest to external actors, it is reasonable that the information contained within financial reports prepared according to external requirements forms the basis for the accounting information used in internal decision-making. The theoretical suggestion of mutual dependency between financial and management accounting has shown to be very strong in practice as well, and the general development shows signs

---

<sup>9</sup> Together the financial accounting system and management accounting system make up the *accounting system (AS)* which, according to Samuelson (1990), forms an important part of a company’s *accounting information system (AIS)*. The entire AIS comprises, besides financial and management accounting (i.e. the AS), also the budgeting system and the product costing system (Samuelson, 1990).

that this connection has gradually become even stronger (Johansson & Samuelson, 1998; Johansson & Östman, 1992).

In the IASB Framework the connection between financial accounting and management accounting is noticed, and attention is paid to the matter that financial reports are actually based on the information used by management in their internal planning, decision-making and control activities. Still, the reporting of information for such internal uses is declared to be beyond the scope of the framework (IASB, 2005). Management, it is established, has access to additional management and financial information for internal purposes and can “determine the form and content of such additional information in order to meet its own needs”.

### **2.1.1 Usefulness: Qualitative characteristics of financial reports**

The delicate issue of what information should be considered as useful in relation to the economic decision-making purpose of financial reports has been handled by the most important national and international authoritative standard setters by references in their conceptual frameworks to a number of qualitative characteristics. The criteria are defined broadly and even if there are differences between frameworks as regards definitions and the significance assigned to the various criteria, the implications are fundamentally the same (Svensson, 2003). In the following the principal qualitative characteristics – relevance, reliability, comparability and understandability - that financial information according to the IASB Framework (IASB, 2005) should possess, will be presented.

First, financial information has to be relevant to its purpose of providing information for economic decision-making, i.e. the information must fulfil the *relevance* criterion. Of significance in this respect is the predictive value of information as well as the confirming feature of financial information:

*“Information has the quality of relevance when it influences the economic decisions of users by helping them evaluate past, present or future events or confirming, or correcting, their past evaluations”. (IASB 2005: IASB Framework, §26, p. 38)*

The predictive value of financial information is considered to go hand in hand with the confirmatory value since information on financial position and earlier performance is frequently used as the basis for predicting the financial position and performance in the future. It is also emphasized in the IASB Framework that information do not need to be in the form of an explicit forecast in order to have predictive value.

### *Frame of reference*

On a more concrete level, the IASB considers relevant information to be composed of information on financial position, performance and changes in financial position, which is presented in the form of balance sheet, income statement and cash-flow statement. This is consistent with the view that traditionally has been put forward by the profession (Kam, 1990). Closely connected to the relevancy criteria, and relevant in the assessment of whether a specific item should be included in the financial reports, is the concept of materiality. An item is according to the IASB Framework material if its omission or misstatement could influence the economic decisions that users take based on the financial statements (IASB, 2005: IASB Framework, §§29-30, pp. 38-39).

In addition to being relevant to its purpose financial information also has to be reliable. According to the *reliability* criterion information should not be unreliable in nature or representation to such an extent that its recognition is potentially misleading. Information is considered to have the quality of reliability “when it is free from material error and bias and can be depended upon by users to represent faithfully that which it either purports to represent or could reasonably be expected to represent” (IASB, 2005: IASB Framework, §31, p. 39).

Financial statements are not free from bias “if, by the selection or presentation of information, they influence the making of a decision or judgement in order to achieve a predetermined result or outcome” (IASB, 2005: IASB Framework, §36, p. 40). Even if information is free from bias it may anyhow be less than a faithful presentation of that which it intends to portray. In a situation for instance where financial information on a certain claim is considered as relevant, it still might not meet the reliability criterion since it cannot be measured faithfully. According to the framework it may anyhow be appropriate to disclose the amount and the circumstances of the claim. In yet other situations, it may be relevant to recognise the item but to disclose information on the risk of error in the recognition and measurement of the item.

It is evident that it may not be without problem to combine the two criteria of relevancy and reliability in practice. In order to make sure that financial information is reliable, for instance, there may be a delay in the reporting of the information with the consequence of impaired relevancy. Conversely, in order to provide information on a timely basis it may be necessary to report before all aspects of a transaction are known, which leads to impaired reliability. In achieving a balance between relevance and reliability, however, the overriding consideration should be how to best satisfy the economic decision-making needs of users (IASB, 2005: IASB Framework, §43, p. 41).

According to the third criterion, *comparability*, information on financial position, performance and changes in financial position should be comparable both through time and between enterprises. A consequence of this criterion is that enterprises should measure and display the financial effect of like transactions in a consistent way over time. In all that, it is not considered to be appropriate for an enterprise not to change its accounting policies when more relevant and reliable information exists, implicating that the comparability criterion to some extent is secondary to the relevancy and reliability criteria.

Lastly it is suggested that information can never be relevant if users are not able to appreciate its content. The criterion *understandability* is in a sense more related to the qualities of the user than of the information. According to this criterion, information has to be readily understandable by users, but it is also assumed that users have reasonable knowledge of accounting and business matters. It is in the IASB Framework further emphasized that “information about complex matters that should be included in the financial statements because of its relevance to the economic decision-making needs of users should not be excluded merely on the grounds that it may be too difficult for certain users to understand” (IASB, 2005: IASB Framework, §25, p. 38).

### 2.1.2 Underlying assumptions

The IASB Framework distinguishes between the qualitative characteristics that financial statements should possess in order to be considered as useful - relevance, reliability, comparability and understandability - and the underlying assumptions that should guide all financial reporting under IASs/IFRSs. There are two underlying assumptions described in the framework (IASB, 2005: IASB Framework, §§22-23). Firstly, it is assumed that financial statements are prepared according to the *accrual basis* of accounting which means that economic events are recorded when they take place without waiting for the corresponding inflow or outflow of cash. Secondly, financial statements should normally be prepared on the assumption that an enterprise is a *going concern* that will continue in operation for the foreseeable future.

## 2.2 Financial reporting in the SME context

Not only have major standard setting bodies almost exclusively focused on large, public enterprises in their development of conceptual frameworks and accounting standards, but also accounting researchers have traditionally directed their inquiries towards this group of companies. During the past few decades, however, both standard setters and researchers have attended to smaller entities to an increasing extent. Since this study focuses on financial

### *Frame of reference*

reporting in the SME context - more specifically the entrepreneurial entities within the SME group – it is appropriate to sort out the extent to which accounting standard setters have taken into account the results of academic studies when developing accounting solutions for SMEs.

#### **2.2.1 *Financial reporting and SMEs in the academic literature***

When attention is directed to the academic literature about accounting in SMEs, it becomes clear that the issues of users and their information needs in the SME environment are not very well represented in accounting studies. There are, however, a few but dated studies offering suggestions concerning which actors make use of SMEs' financial reports and what their information needs are.

The suggestion by the IASB's SME Advisory Panel that the users of SMEs' financial reports are principally the same as users of large and/or public enterprises (see section 1.1) does not find support in the literature. Even if there are characteristics that bound enterprises together irrespectively of whether they are large and/or public or privately-held SMEs, it is also possible to find qualities of the latter group of enterprises that differentiates it from the first group in ways that might be critical when it comes to users and their information needs. For one thing, the ownership situation tends to be very different in a smaller company than in a larger publicly-held one. While the ownership of a public enterprise generally is largely dispersed, the ownership of smaller private entities is generally concentrated to a much higher degree (Page, 1984; Lippitt & Oliver, 1983). This circumstance, together with the fact that changes in ownership generally occur more seldom in smaller enterprises than in large ones, implicates that the assumption that investors are the main users of enterprises financial reports is debatable in an SME environment.

Furthermore, because of the limited access that the small business in general has to capital markets, the main sources of external capital are often bank loans and other short-term debt (Cressy & Olofsson, 1996; Storey, 1994). There are also studies suggesting that small and medium-sized entities in general are control averse which means that they, in situations where there is a need of external finance, prefer seeking finance in the form of loans and other short-term credits rather than inviting new shareholders to the business (see for instance Olofsson & Berggren, 1998).

As opposed to larger enterprises where management frequently is separated from ownership, the control of small companies is to an overwhelming majority in the hands of directors, i.e. management and ownership is often carried by the same, or the same few persons (LeCornu et al., 1996; Page, 1984;

Lippitt & Oliver, 1983). Accordingly, owners of smaller enterprises often have greater insight into the affairs of the enterprise and it could be argued that they would be less dependent upon formal financial reports than shareholders of large businesses.

Another feature that makes smaller entities different from larger ones is that management often performs multiple management roles - at least if the enterprise belongs to the smaller group on the SME spectra - which makes the typical small business manager familiar with most aspects of the business (Lippitt & Oliver, 1983). From such a perspective, it could be argued that managers of smaller entities should be less dependent upon formal financial statements than their counterparts in large businesses. There are studies however suggesting that management actually belongs to the main user groups of SMEs' financial reports. For instance, in a study conducted by the AICPA (1976) managers were, alongside of owner-managers and bankers, identified as a main user group of smaller and/or privately-held businesses' financial reports (Bushong, 1995). Furthermore, in a study by Page (1984) where directors were asked to rank uses and, by implication, users of their company's financial accounts it was found that the function of management information was accorded highest priority. Other functions of the annual accounts which were accorded importance were as a basis for tax computations and information to the bank or other providers of finance. Further evidence that management belongs to the main user groups of financial reports can be found in the more recent studies by Jarvis (1996) and Collis & Jarvis (2000).

The proposition presented here that management should be considered as a main user of financial reports hints in a direction that is not consistent with the view put forward in the IASB Framework and which is reflected in the IASB SME-project descriptions. When taking the stand, as done in the framework, that management is not included among the main users of regulated accounting reports it is presumed that companies voluntarily devote resources to the development and use of complementary accounting information needed for internal decision-making. Research however has shown that the extent to which management accounting systems are developed and used varies between companies. For one thing, it has been suggested that the sophistication of management accounting systems is contingent on the size of companies. As proposed by Thomas (1986), as size increases so does the sophistication and formalisation of accounting systems. Also it has been suggested that financial accounting information prepared according to accounting regulation is attached a greater relative weight in the accounting system as a whole in small companies than in larger ones (e.g. Samuelson, 1990).

Concerning the information needs of users of SMEs' financial reports, there are a few studies investigating the use of various parts of the financial reports, such

### *Frame of reference*

as the income statement and the balance sheet. However, these studies do not look into what is actually needed in terms of information and whether the information needs are satisfied by the reports (McMahon & Holmes, 1991). When the question of whether the information contained in financial reports meets the needs of users is actually addressed, the information needs are not put in relation to the issue of differential regulation, and it is not made clear whether the evaluated financial reports are prepared according to differential regulation or not (e.g. Svensson, 2003; Bergström & Lumsden, 1993). In addition, existing studies of the use of accounting information within enterprises, i.e. internally by management, tend to focus on the accounting system as a whole, including both regulated and non-regulated information, without any specific attention directed to the function that the regulated part plays in the system as a whole (e.g. Johansson & Samuelson, 1998; Bergström & Lumsden, 1993).

Moreover, when the issue of differential accounting is addressed it is mostly in the form of theoretical discussions rather than empirical investigations (e.g. Dugdale et al., 1998; Lippitt & Oliver, 1983). Discussions also tend to focus on the “burden” that accounting regulation puts on the reporting entities rather than on the issue of whether the financial reports meet the information needs of users (e.g. Keasey & Short, 1990). Although it is a good thought that the financial reporting regulation should not put indefensible demands upon reporting entities, it seems reasonable to expect that the information needs of users are also credited with high priority by standard setters when developing accounting standards for SMEs.

## **2.2.2 Financial reporting and SMEs according to standard setters**

### **2.2.2.1 The IASB project on financial reporting standards for SMEs**

During the past few years, the IASB has been working on a project with the aim of providing high quality, understandable and enforceable accounting standards that are suitable for entities that (1) do not have public accountability and (2) publish general purpose financial statements for external users. The intention is to reduce the financial reporting burden on SMEs that want to use global standards, while at the same time seeing to that the information needs of the users of their financial statements are met. (2006a)

The point of departure for the IASB research project is that the accounting standards for SMEs should be built on the same conceptual framework as IFRS's (IASB, 2004). In the latest draft of an International Financial Reporting Standard for Small and Medium-sized Entities (*IFRS for SMEs*) published on

the IASB website in early august 2006, it is stated that the objective of financial statements provided by SMEs is to provide information on the financial position, performance and cash flows that is useful to a broad range of users in their economic decision-making (IASB, 2006b). The main users, whose information needs the IASB intend to look after by the coming *IFRS for SMEs*, are external users such as owners not involved in the management of the business, existing and potential creditors, and credit rating agencies. Users “who are in a position to demand reports tailored to meet their particular needs” such as owner-managers and the tax authority are thereby excluded from the target audience (IASB, 2006b).

Even though the qualitative characteristics as described in the August 2006 draft do not include all dimensions of the concepts mentioned in the IASB general framework, the content is largely the same. That is, in order to be useful to users the information provided in SMEs’ financial reports should be relevant, reliable, comparable and understandable (IASB, 2006b). Also the underlying assumptions of the IASB’s general framework are represented in a similar way in the draft as in the general framework. Accordingly, it is assumed that SMEs should prepare their financial statements, except for cash flow information, on the accrual basis of accounting, and also that the financial statements in general should be prepared on a going concern basis (IASB, 2006b).

In July 2009 the IASB published an *International Financial Reporting Standard for SMEs (IFRS for SMEs)* (IASB, 2009).

### 2.2.2.2 The Swedish BFN project on accounting standards for non-public entities

According to the current Swedish accounting regulation system, which has been in use since 1998, privately-held enterprises can either choose to apply the IFRS/IAS-based accounting standards that are issued by *Redovisningsrådet*, and which are statutory for public companies, or the “general advice” (Allmänna Råd, AR’s) that are issued by *Bokföringsnämnden*. The general advice is mainly simplifications of the standards issued by *Redovisningsrådet* where the extent of the simplifications is dependent upon company size; while small companies are “rewarded” with the greatest simplifications increased demands are imposed on medium-sized and large companies.

Since the general advice have turned out not only to be too complicated and incomprehensible for preparers but also to result in financial statements that are not very comparable and too difficult for users to interpret (BFN, 2004a & 2004b), *Bokföringsnämnden* is presently engaged in the development of a completely new set of differential standards. With the aim of better meeting the

### Frame of reference

needs of users of SMEs' financial statements this new set of standards commences from a division of enterprises into four size categories:

- K1: Sole proprietorships or partnerships with a turnover of more than €0,3 million.
- K2: Limited companies and co-operatives with less than 50 employees, less than €2,5 million in assets and a net turnover of less than €5 million.
- K3: Larger non-public companies and co-operatives.
- K4: Public entities or entities with a high degree of outside interest obliged to prepare their consolidated accounts according to IFRS.

The generously simplified standards that are included in the general advice aiming at the categories K1 and K2 are already in use. The K2 standard is to be applied optionally on annual accounts of 2008 and onwards. The point of departure for *Bokföringsnämnden's* ongoing work with developing the accounting standard for larger non-public companies belonging to the size-category K3 is IASB's *IFRS for SMEs* (BFN, 2009).

Concerning the category K2, drafts of a general advice have been published on two occasions, in 2006 and in 2007. According to the official report that preceded the 2006 draft, and which was developed by *Bokföringsnämnden* and the Swedish tax authority together, the working presumption has been that the accounting rules for entities belonging to the K2 category should be designed in order to meet the information needs of mainly creditors and the tax authority (BFN, 2006b). The information needs of other users such as owners and employees are assumed to be met by other means than the official financial reports.

In the March 2006 report it is further emphasized that it is considered to be no major differences between the major users of the K2 entities' financial reports – creditors and the tax authority – and also that it is desirable to minimize the differences between accounting rules and tax rules. The report also urges the development of accounting rules that meet the criteria of understandability and comparability and it is assumed that the information needs of both creditors and the tax authority will be met by a simple regulation based on valuation at acquisition cost and prudence.

### 2.2.3 Implications for this study

Regarding the higher-order purpose of financial reports, the point of departure for the IASB research project on SME accounting is that SMEs' financial reports should be useful to users in their economic decision-making. When turning to the Swedish accounting regulation system, there is no reference made to the economic decision-making objective in the drafts and reports published on *Bokföringsnämndens* website. The point of departure for the study presented in this thesis is that the users rely on entrepreneurial SMEs' financial reports in order to make economic decisions of various kinds. This is not to say that the economic decision-making objective is the only one since there may certainly be other purposes, and most definitely there are other consequences of using financial reports – desirable or not – than the efficient allocation of resources. In all that, one important purpose of financial reports, in entrepreneurial SMEs as well as in SMEs in general, SMEs in general, and also in larger and/or public enterprises, should still be to provide users with information that is relevant in the making of economic decisions.

In the IASB SME project work it is assumed that financial information - in order to be useful to users in their economic decision-making - should be relevant, reliable, comparable and understandable. In the drafts and reports published on *Bokföringsnämnden's* website the qualitative characteristics of financial reports is not explicitly discussed, but anyhow it is made clear that great importance is attached to different aspects of reliability (prudence), comparability and understandability (BFN, 2004a, 2004b & 2006b). This study assumes that it is reasonable to expect the criteria of relevancy and reliability to hold in an SME environment as well, considering their very broad definitions in the IASB Framework.

Concerning the comparability criterion, it is inevitable that the differentiation of accounting rules for SMEs will be detrimental to the extent to which the financial reports are comparable and consistent between enterprises. Not only do two entities have to belong to the same size class in order for their financial reports to be comparable; if the entities have the possibility to choose between the differential and “regular” rules, their financial reports can only be comparable if the entities choose to prepare their financial reports according to the same rules. In the IASB Framework it is, however, emphasized that the comparability criterion should be seen as secondary to the criteria of relevancy and reliability. Accordingly, if an accounting solution is considered to lead to the provision of more relevant and reliable information to the users of SMEs' financial reports, such a solution should not be rejected merely because of the detrimental effect that it might have upon comparability.

### Frame of reference

Turning to the understandability criterion, it is certainly important that the financial information prepared according to the accounting regulation is not complicated to such an extent that users of SMEs' financial reports have severe difficulties in understanding it. To exclude information that is useful to some users merely because it is hard for other users to understand is not acceptable in large and public enterprises, and from a theoretical perspective it could be argued as unacceptable for SMEs as well. Considering that the discussions on the need of differential accounting regulation for SMEs often have focused on the burden that accounting regulation puts on the reporting entities (e.g. Keasey & Short, 1990), the proper treatment of the concept of understandability is not as clear-cut in reality, however. From the perspective of entrepreneurial SME managers – which is the centre of attention in this study - this does not, however, appear as a serious problem considering that several studies have revealed that entrepreneurial managers not only are engaged in accounting issues, and frequent users of accounting information (Dergård, 2006; Blomkvist, 2008; Hansen; 2005, Lundell, 2005), but are also eager to learn more about accounting-related issues (Sexton et al., 1997).

Concerning the applicability of the underlying assumptions it seems reasonable to expect the assumption of going-concern to be valid in the SME-context considering that the users are expected to make their decisions for the future. The treatment of the assumption of accrual-basis is not as evident, however, when considering the increasing interest in cash-flow accounting, not only in the literature but also among practitioners (Pauli, 1999). The main arguments for cash-flow accounting are that it provides information that is not only more relevant, objective and reliable than accrual-based accounting information, but also easier to grasp by users. Even so, the predominant view among accounting researchers and other debaters is that the income concept is the most efficient in predicting future cash-flows (Artsberg, 2005). Could it be that the best solution – for SMEs as well as for large public enterprises – is not to choose either accruals or cash flow but rather to let the methods supplement each other? In that case the wording by the IASB in the draft of an *IFRS for SMEs* appears relevant in that “it is assumed that SMEs should prepare its financial statements, except for cash flow information, using the accruals basis of accounting” (IASB, 2006b).

Accordingly, the study presented in this thesis sets out from the assumption that the higher-order purpose, the qualitative characteristics and the underlying assumptions of financial statements are applicable in the context of entrepreneurial SMEs.

## 2.3 Entrepreneurship

Despite the large number of studies that have investigated various aspects of the entrepreneurship phenomenon during the past few decades, researchers have not been able to unite on a single definition of the concept. Some researchers stress that entrepreneurship has to do with the creation of new organizations (Gartner, 2001), while others claim that entrepreneurship certainly occurs in already existing organizations as well (Davidsson et al., 2002). The concept of entrepreneurship is also frequently used with reference to the management of small and/or family firms in general. The issue of the “correct” organizational setting is, however, not a problem according to the widely cited Shane & Venkataraman (2000) since entrepreneurship is viewed as the discovery and exploitation of profitable opportunities. The focus on opportunities implicates that entrepreneurship according to this contemporary definition can be practiced within an existing organisations as well as by the formation of a completely new organization.

Accordingly, opportunity is a concept that is central when discussing entrepreneurship and that can take many forms. According to Davidsson, Delmar & Wiklund (2002), who restrict the entrepreneurship phenomenon to the market context, a business opportunity should not only be new to the firm but also change the product or service offers that are available on the market. Entrepreneurial opportunities may for instance involve the innovation or discovery of completely new products or services, but also the exploitation of existing products on new markets. Furthermore, activities such as the development of new production technology or the internal reorganization would also count as entrepreneurial as long as they bring about changes in what is offered on the market (Davidsson et al., 2002).

Traditionally, entrepreneurship researchers have primarily been concerned with the innovative abilities of individual entrepreneurs. In a small and newly founded firm, the entrepreneur has a major influence on the entrepreneurial activities carried out in his or her firm. When an enterprise develops and grows, however, more people are likely to get involved in its management and accordingly the influence of the individual entrepreneur diminishes. In these situations it is significant to recognise entrepreneurial dimensions of strategy in addition to individual level entrepreneurship (Wiklund, 1998). The concept of entrepreneurial orientation (EO) initially developed by Miller (1983), refers to a firm’s strategy and comprises specific entrepreneurial aspects of decision-making styles, methods and practices (Davidsson, Delmar & Wiklund, 2006). In an entrepreneurial oriented firm there is a willingness to engage in innovation, take risks to try out new and uncertain products, services, and markets, and be more proactive than competitors toward new marketplace opportunities (Wiklund & Shepherd, 2005).

### 2.3.1 Entrepreneurship and growth

From the entrepreneurship literature, it appears that there is a consensus among academics that the concept of entrepreneurship is closely connected to growth (e.g. Gartner, 1990). Such a connection does however not imply that we will find entrepreneurship wherever we find growth, or that we will find growth wherever we find entrepreneurship. Growth can take many forms and some forms rather than others can be considered as manifestations of entrepreneurship. While the organic growth that occurs because of the successful exploitation of new business opportunities can be considered as a reflection of entrepreneurship (Wiklund & Davidsson, 1999), the growth that follows from an acquisition, where a new business is merely added to the original entity without the creation of any surplus value, will not count as such. In all that, Davidsson, Delmar & Wiklund (2002) suggest that the assumption that “growth is entrepreneurship” is a realistic generalization for young and small firms, but not for large and old ones. The reasoning for this is that younger and smaller firms to a greater extent than older and larger ones tend to grow organically rather than through acquisitions (Davidsson & Delmar, 1998). Consequently, even if entrepreneurship certainly happens in various types and sizes of organizations, acting in the most varying lines of business, it can be concluded that if we study newer and smaller growing enterprises we will probably find out that the growth is organic as a result of successful entrepreneurship.

When studying entrepreneurship, there are many different ways in which the growth of an enterprise can be measured. With reference to previous studies showing that sales is the most common indicator among entrepreneurs themselves (Hoy, McDougall and D’souza, 1992; Barkham et al., 1996), Davidsson & Wiklund (2000) emphasize the importance of sales when measuring growth. Other important aspects of growth that can be used as measurements are total assets and number of employees. The use of multiple measures may, however, be preferable to individual measurements since they provide richer information (Davidsson & Wiklund, 2000).

The concept Gazelle, which refers to small and organically fast-growing enterprises, was originally developed by Birch (1979) who already in the 1980s showed that this group of entities created most new jobs in comparison to larger and established enterprises. To inspire growth and entrepreneurship, the Swedish business paper *Dagens Industri* yearly rewards the fastest growing enterprises in the country with a Gazelle diploma, which has made the concept well known in the Swedish business world. To achieve the label Gazelle, there are a number of criteria that should be fulfilled, including a 100 % increase in sales turnover throughout a period of three financial years; the growth of the entity should in all essentials have been organic and not achieved through

mergers or acquisitions, and the entity should be in a healthy financial position (*Dagens Industri*, 2009).

### 2.3.2 Growth and the demand for financial resources

When a firm grows, its management faces a number of unique problems. One such problem is how to handle the increased demands for financial resources that the growth brings about (e.g. Sexton et al, 1997; Storey, 1994). Berggren, Lindström & Olofsson's (2001) two studies investigating the financial position of Swedish SMEs show that managers of growth-oriented enterprises, to a greater extent than their counterparts in non-growth enterprises, consider the limited resources of capital – internally generated as well as externally acquired - as a serious obstacle to development (see also the one-case study performed by Collier, 2005, which is presented in chapter 3). Even if internally generated financial resources are seen as the most important source of capital in growth-oriented enterprises as well as in non-growth enterprises, it is also shown that managers of growth-oriented enterprises are more positive in general towards various types of external finance. In conformity with Storey (1994) the studies by Berggren et al. (2001) also show that the owner structures of growth-oriented enterprises incorporates more categories of owners, and also that external owners, i.e. owners that are not managers or family of managers, in general hold a greater lot of shares than is the case in non-growth enterprises. Furthermore, growth enterprises tend to be financed by investment companies, venture capitalists and other companies to a larger extent than is the case in non-growth enterprises (Berggren et al., 2001). The studies by Berggren et al (2001) also reveal that bank financing tend to be considered as slightly less important in the growth-oriented enterprises than in the non-growth enterprises.

### 2.3.3 Implications for this study

The main purpose of this study is to sort out areas of financial reporting information that are likely to be of significance to managers of entrepreneurial SMEs in their provision of information to users. The focus on managers of *entrepreneurial SMEs* rather than *entrepreneurs* within SMEs implies that the concept entrepreneurship is connected to the entity as a whole rather than to an individual entrepreneur, or a few individual entrepreneurs, within an entity. The reasoning for this focus is based on the idea behind the concept entrepreneurial orientation (EO), i.e. that the influence of an individual entrepreneur on the entrepreneurial activities carried out in an enterprise usually diminishes when it develops and grows and more people are involved in its management. In addition, the focus of this study on statutory accounting information, which is prepared for the entity as a whole, provides with further argument for the focus

### *Frame of reference*

on entrepreneurial SMEs rather than individual entrepreneurs, since individuals may be accountable only for a part of the business carried out by the enterprise.

Consequently, in this study the definition of an entrepreneurial SME, as presented in section 1.3, has been developed with the concept of entrepreneurial orientation as a point of departure, together with the assumption that organic growth is closely connected to successful entrepreneurship. More specifically, the term *entrepreneurial SME* is in this study used with reference to an entity within the SME group managed by growth-oriented individuals who are eager to engage in new development projects and exploit new product areas or markets, in order to take advantage of new business opportunities faster than competitors (see section 1.3).

The focus on opportunities of this study's definition of entrepreneurial SMEs is in line with the fundamental idea behind the Shane & Venkataraman (2000) view of entrepreneurship, which is also applied in previous studies about accounting in entrepreneurial contexts (Blomkvist, 2008; Dergård, 2006; Hansen, 2005; Lundell, 2005).

The academic literature suggests that the main users of SMEs financial reports include managers, providers of loan finance, suppliers, employees and the tax authority. With reference to the entrepreneurial context, however, there is a tendency among entrepreneurial entities – as growth increases the demands for financial capital - to rely on external financial capital to a larger extent than what is the case in established SMEs. For the present study this would implicate that we can expect external financiers – including risk capitalists – to belong to the main user groups of entrepreneurial SMEs financial reports to a greater extent than what is the case in SMEs in general.



### 3 Literature study of previous empirical studies of accounting in entrepreneurial contexts

This chapter looks into previous empirical studies about accounting in entrepreneurial contexts, which makes up the first step of data collection of the study presented in this thesis. The chapter firstly presents the mode of procedure for the sorting out and analysis of the studies included in the literature study. Then, the results of the literature study are presented, and the chapter closes with a summary of the results.

#### 3.1 Mode of procedure

Five studies have been chosen for the literature study presented in this chapter<sup>10</sup>. Four of the studies (Dergård, 2006; Lundell 2005; Hansen, 2005; Blomkvist, 2008) have been conducted by members of the research programme *Accounting in an entrepreneurial context*<sup>11</sup>, of which the author of the present study is an associated member. An additional search through scholarly journals using the search words accounting, entrepreneur/ship/ial and similar gave many hits in a great number of articles. The titles and – when needed in order to sort out the main themes – abstracts of the articles were read through in order to sort out articles dealing with the use of accounting information in an entrepreneurial context. During this procedure, studies dealing with accounting measurements only from a very general point of view, and/or studies defining entrepreneurship in a broad sense as small business enterprising or the management of start-ups, and thereby given a very general meaning<sup>12</sup>, were disregarded from further inquiry. In this way a fifth study (Collier, 2005) was identified and included into the literature study.

In the majority of the studies presented in this chapter, the focus has been on entrepreneurs' use of accounting information in the internal management of their businesses with no distinction made between accounting information in general and financial reporting information, i.e. accounting information prepared according to the accounting regulation. Nevertheless, it is likely that external users of an entrepreneurial entity's financial reports are interested in

---

<sup>10</sup> The literature study was conducted during autumn 2007.

<sup>11</sup> The research programme is headed by Professor Olov Olson, School of Business, Economics and Law, Gothenburg University.

<sup>12</sup> See section 1.3 and 2.3 above for this study's definition of entrepreneurship.

about the same areas of information as the entrepreneur managing the business. Therefore, even if none of the studies have been conducted with the aim of sorting out the usefulness of statutory accounting information *per se*, they still provide with relevant indications of areas of financial reporting information that are likely to be essential in the context of entrepreneurial SMEs.

In order to sort out items of accounting information put forward as important by the studied entrepreneurs, the five studies have been carefully read with a focus on empirical data and results. The results of this analysis are presented in the following section. To the extent that users and purposes of financial reports have been discussed within the analyzed studies, the studied entrepreneurs' views in this respect are also presented.

## 3.2 Results of the literature study

Dergård's (2006) study of seventeen successful entrepreneurs contend that these entrepreneurs use accounting information for decision-making in the processes of discovery and exploitation of entrepreneurial business opportunities as well as in on-going business operations. In the study the concept of accounting information is defined in a wide sense including all information that the entrepreneurs use in their endeavour to achieve economic goals. According to the empirical data and results of the study, the entrepreneurs use financial as well as non-financial information about both external and internal conditions. The studied entrepreneurs, who use internally as well as externally-based sources of information, consider both information about the past and the future to be valuable. The nature of the accounting information used, however, varies between the different stages of the product life cycle. The entrepreneurs in Dergård's study use financial information about the entity mainly in the exploitation stage and in the management of on-going operations. In the exploitation stage, information to evaluate the opportunity, to acquire resources and to combine the resources in a new way is considered significant. Concerning the management of on-going operations the studied entrepreneurs use *ex post* financial information to evaluate the success of exploited opportunities. In both exploitation and management of on-going operations, the entrepreneurs tend to rely on information related to sales, profit, profitability and cash flow. In planning and evaluation of on-going operations, the greater part of the studied entrepreneurs focuses on contribution margin.

Lundell (2005) studied a financially successful entrepreneur's (that is the owner and manager of a company that can be characterized as an SME) use of accounting information in perceiving risk. The results of the study show that the entrepreneur uses accounting information in order to perceive risk in

*Literature study of previous empirical studies of accounting in entrepreneurial contexts*

managing operations as well as in entrepreneurial processes. In the daily management of operations, the entrepreneur keeps himself updated on sales, variable costs and cash flow, which are seen as fundamental figures in terms of the short-term control of the business. In entrepreneurial processes, accounting information is considered crucial in determining whether an opportunity should be exploited or not. Since the entrepreneur is constantly involved in the update of accounting figures, he can quickly decide whether an entrepreneurial opportunity is economically feasible to exploit or not. In cases where an opportunity turns out to be appealing as well as economically feasible, additional and more exact information – including accounting information – is collected. With respect to financial reporting the entrepreneur studied by Lundell supplements the balance sheet and income statement with a cash flow statement - even though this is not required by Swedish accounting legislation - since he believes that it incorporates important information that is “hidden by the accounting figures” in the statutory reports. Regarding financial risks the entrepreneur prefers the financial independence that a high equity ratio offers, which confirms the suggestion by Berggren, Lindström & Olofsson (2001) that growth-oriented managers, just as managers of SMEs in general, consider internally generated financial resources as the most important source of capital (see section 2.3.2 above).

Hansen (2005) inquires into the use of accounting information in two entrepreneurial companies operating in quite different contexts. Since one of the studied companies in terms of size by far exceeds the limit for being an SME, it is only the smaller case company that can be characterised as an SME. The study shows that accounting information is vital and is used actively for decision-making, control and organizational learning in both companies. The reports these entrepreneurs are mostly interested in are relatively short-termed but the monthly profit and loss accounts as well are considered important. In the SME that operates in a less complicated environment that is easier to survey than the context of the larger company, a more standardised accounting system is in use. The entrepreneur managing the SME relies to a high extent upon formal reports where the focal point is on revenues, variable costs (COGS are considered to be of certain significance) and gross margin. In the larger company, the formal systems are to a greater extent complemented by oral information and discussions, and the most important factors are believed to be non-financial, such as production yield and volume.

In short, these three studies are mainly concerned with the use of accounting information for internal decision-making purposes. In the following two studies, attention is also paid to the role of accounting information in informing external actors. To begin with, the Australian longitudinal study by Collier (2005) illustrates how a simple spreadsheet model designed by the entrepreneur himself successively grows into a sophisticated tool for accounting control as

well as for informing external financiers. The original spreadsheet model, which was intended for internal use and cash-flow dominated, was used not only as a historical record but also as a forecasting device and a tool for ongoing decision-making. Since heavy investments were made regularly in R&D and market development, a recurrent issue was how to access funds for expansion. Even if most of the capital needs were met by internally generated profits, the rapid development required additional funds in terms of bank loans. Due to bankers' unwillingness to lend against financial projections there had been situations when the entrepreneur had to invest funds, that otherwise would have been invested in R&D and market development in, real estate. Gradually however the entrepreneur experienced that the spreadsheet model facilitated his communication with his bankers and, as a consequence, the expansion of the business within the cash flow and borrowing capacity.

When the enterprise grew bigger, the cash-flow spreadsheet was developed to include industry and market share modelling in order to reflect the long-term goals of sales growth. Since the matching principle was not applicable due to the lead time between investments in research and development (R&D), export market development and patent litigation, and the subsequent inflows of cash, traditional accounting reports were not considered to provide with the relevant information on profitability. Accordingly, income statements and balance sheets were only prepared at year-end to satisfy external requirements.

The final study of this section looks into the involvement by entrepreneurs in the year-end procedures of constructing financial statements. Blomkvist's thesis (2008) consists of two empirical inquiries where the first one is a qualitative pilot study investigating the involvement of five entrepreneurs managing small<sup>13</sup> growing enterprises in the year-end procedures of constructing financial statements. The aim of her study is to describe if and how entrepreneurs engage in the process of constructing financial statements and to explain the reasons for the entrepreneurs' participation. The results of the study show that the studied entrepreneurs are not merely participants in the process of creating annual accounts but highly active in both discussions on how to give accounts in a proper manner, and the very procedure of doing so. Among other things, the entrepreneurs' wish to influence the content of the financial statements in order to assure that the information needs of users are satisfied. Three of the five entrepreneurs studied by Blomkvist mention shareholders and other financiers – of which one is a risk capitalist - as important in this respect. The other two entrepreneurs, who are the sole owners of their businesses, consider customers to be significant to inform by means of the financial reports.

---

<sup>13</sup> All five enterprises of Blomkvist's pilot study have less than 50 employees.

*Literature study of previous empirical studies of accounting in entrepreneurial contexts*

Four of the entrepreneurs studied by Blomkvist also consider it important to stay informed about the financial aspects of the business at an early basis in order to be able to provide well-founded answers to questions from shareholders and other financiers. Three of the entrepreneurs state that they participate in order to inform themselves, i.e. for decision-making purposes of their own, on past performance and to make well-founded decisions for the future. As expressed by one of the interviewed entrepreneurs: “if you do not know where you are and where you have been, you will neither know where you are heading” (Blomkvist, 2008, p. 45). In the process of constructing the financial reports, one of the entrepreneurs further states that information is also produced on contribution and margins that is significant future-oriented information for the pricing of the company’s products.

The entrepreneurs are particularly attentive to intangible assets, stock and work-in-progress, and accounts receivable, and among these the treatment of intangible assets receives the most attention (Blomkvist, 2008). In this respect the discussions centre on whether the investments in intangibles should be treated as assets or not, and the consequences of the different procedures. In addition, one of the entrepreneurs calls attention to the importance of being well-informed on present intangible assets since this item contains significant information for the planning and monitoring of future intangible projects. All of the studied entrepreneurs also write the directors’ report of their entities financial reports.

Blomkvist’s (2008) quantitative main study compares entrepreneurs in successful fast growing firms – so-called Gazelles – and managers of non-growing firms and their participation in the year-end procedures, with respect to the valuation of the items of intangible assets, stock (including work-in progress) and accounts receivable. She contends that entrepreneurs in fast growing firms use and produce formal financial accounting information, and they participate in the year-end procedures to a greater extent on the whole than managers of non-growing firms of similar size, leverage and profitability. Concerning the different assets in focus, the entrepreneurs spend more time compared to managers of non-growing firms discussing the value of stock and work in progress and accounts receivable. Concerning the valuation of intangible assets, the result of the quantitative analysis shows no significant difference between the two groups of firms, even though the mean time that the entrepreneurs spend on discussions on the valuation of intangible assets is three times the time spent by managers of non-growing firms.

### **3.3 Summary of the results of the literature study**

With reference to the users of entrepreneurial SMEs financial reports, data is mainly provided by Blomkvist's (2008) pilot study, which is the only one of the examined studies that has had statutory financial reports as an explicit focus. The empirical data and the results of Blomkvist's study indicate that one of the reasons why entrepreneurs wish to participate in the year-end procedures of constructing financial reports is to satisfy the information needs of users. The most important users in this respect are shareholders and other financiers (including a risk capitalist) and customers. Four of the five entrepreneurs studied by Blomkvist also consider it important to participate in the construction of financial reports for the reason of keeping themselves updated on financial aspects of the business, not only in order to be able to evaluate past performance but also to make well-founded decisions for the future.

Table 3.1 below illustrates the results of the literature study in terms of the items of accounting information that have been sorted out as important in an entrepreneurial context. The item of accounting information that has received most attention in the analysed studies is sales/revenue; in four out of five studies, the studied entrepreneurs list information on this item as significant. This is in line with Davidsson and Wiklund (2000) who suggest, with reference to Hoy, McDougall and D'souza (1992) and Barkham et al. (1996), that sales growth is the most common performance indicator among entrepreneurs (see section 2.3.1 above). It should be noted however that all of the studies bringing forward information on sales/revenue are mainly concerned with accounting information for the purposes of internal decision-making by the entrepreneurs themselves. Even so, it is not questionable that information on sales/revenues is also crucial to external users of entrepreneurial SMEs financial reports. The item of contribution margin is, on the other hand, not generally used with reference to financial reporting information. Since information on contribution margin, together with the components of contribution (sales/revenue and variable costs), has been put forward as useful in an entrepreneurial context in several of the studies examined in this literature study, it would be interesting to investigate whether information on contribution is also significant to include in the financial reports of entrepreneurial SMEs.

Table 3.1 Important items of accounting information in an entrepreneurial context according to previous empirical studies

<b>Accounting information</b>	<b>Study</b>
Sales/revenue	Dergård (2006) Lundell(2005) Hansen (2005) Collier (2005)
Cash flow	Dergård (2006) Lundell (2005) Collier (2005)
Intangible assets	Collier (2005) Blomkvist (2008)
Variable costs	Lundell (2005) Hansen (2005)
Contribution margin	Dergård (2006) Blomkvist (2008)
Ratios	Dergård (2006) - <i>profitability</i> Hansen (2005) - <i>gross margin</i>
Profit	Dergård (2006)
Stock (including work-in-progress)	Blomkvist (2008)
Accounts receivable	Blomkvist (2008)

Besides sales, and sales in combination with variable costs, accounting information on cash flow has received attention in several of the studies presented in this chapter. The studies by Dergård (2006), Lundell (2005) and Collier (2005) all indicate that entrepreneurs find information on cash flow significant in their economic decisions-making. Collier's study (2005) also suggests that cash flow information can be significant in negotiations with financiers. Considering that privately-held enterprises according to the present Swedish accounting regulation are not required to prepare cash flow

statements, the result of the literature study with respect to cash flow indicates the relevance for a further inquiry into the importance of cash flow information to the users of entrepreneurial SMEs financial reports.

Another item that has been listed as significant in an entrepreneurial context according to my literature study is information on intangible assets. Four out of the five entrepreneurs studied by Blomkvist (2008) are involved in the valuation of intangible assets in the process of constructing financial reports. Among the accounting transactions that the studied entrepreneurs discuss with other participants during the year-end procedures, investments in intangible assets are the most discussed ones. The discussions on intangible assets are in this respect focused on whether the investments in intangibles should be capitalized as assets or expensed, and the consequences of the different procedures. In addition, one of the studied entrepreneurs stresses the importance of being well-informed on present intangible resources since this item contains significant information for the planning and monitoring of future intangible projects. Furthermore, the entrepreneur studied by Collier (2005) consider traditional financial reporting practices - where investments in research and development are poorly matched to the subsequent inflows of cash - to be deficient for the purposes of measuring profitability.

To sum up, according to the results of my literature study, accounting information on especially contribution/contribution margin, cash flow and intangible assets has been sorted out as specifically important in an entrepreneurial context.

## 4 Interviews with accounting experts

As a second step of this study, interviews have been conducted with accounting experts engaged in the contemporary discussion on the development of accounting standards for SMEs.<sup>14</sup> The aim of the interviews has been to sort out the view held by accounting experts concerning the main users and purposes of entrepreneurial SMEs' financial reports, and areas of financial reporting information that are likely to be significant to managers of entrepreneurial SMEs in their provision of information to users. In section 4.1 below, the mode of procedure for this empirical part of the study is presented in terms of the selection of respondents and the process of interviewing and interpretation of interview data. Then, in section 4.2, the results of the interviews with accounting experts are presented.

### 4.1 Mode of procedure

#### 4.1.1 *Choice of respondents*

In a study by Jönsson (1985), subsequently updated by Sandin (1988)<sup>15</sup>, the most renowned authorities on the development of accounting practices in Sweden - the so-called accounting elite - was categorized into four groups including advisors/auditors, opinion leaders/academics, rule makers/standard setters and accountants/preparers. Even though the studies by Jönsson (1985) and Sandin (1988) are somewhat dated, individuals with expert knowledge of accounting and regulation are still expected to be found in the four groups. With reference to the fourth group, however, it is more likely that many accountants/preparers of large and/or public companies<sup>16</sup> hold expert knowledge of accounting and regulation issues - and also engage in the development of accounting practices - than it is concerning their counterparts in SMEs. Therefore, since this part of the study aims to sort out the view held by experts with extensive knowledge and experience in accounting and

---

<sup>14</sup> The expert interviews were conducted during late autumn 2007/early spring 2008.

<sup>15</sup> In Jönsson (1994) a comparison between the results of the original study and the update is provided.

<sup>16</sup> Even though Jönsson (1985) does not clearly express the focus on larger and/or public companies, the limited extent to which both academics and standard setters have attended to accounting issues in the SME environment in the past, legitimizes the assumption that the results of the Jönsson study bear reference to this context, at least to a greater extent than to the SME context.

regulation issues concerning SMEs in specific, and who are also engaged in the current public debate on accounting standards for SMEs, respondents have been selected from the first three groups of the categorization by Jönsson (in the following named auditors, academics and standard setters).<sup>17</sup>

In order to find possible respondents, the electronic database of the Swedish leading professional journal *Balans* - which was identified in the study by Jönsson as a significant forum for the development of accounting practices in Sweden - was searched for articles containing the search word “accounting”, “accounting regulation”, “SME” and/or “entrepreneur” and similar. This search, together with an additional search in the databases *Affärsdata* (includes *Dagens Industri*) and *Libris* (books and dissertations) provided with 21 names of individuals with the relevant skills to qualify for this empirical study. In order to include respondents from all three groups of experts, two auditors, two academics and two standard setters (representing *Bokföringsnämnden*) were selected. In addition to these six accounting experts representing the Swedish context, two standard setters were also selected from the IASB SME group<sup>18</sup> (IASB, 2006a), giving a total of eight respondents. After several unsuccessful attempts to get into contact with one of two academics, the number of experts for interviews was reduced to seven. The selected respondents do not constitute a group big enough to represent the entire population. In an explorative study like this, however, this approach still serves its purposes.

The names of the respondents and their respective category belongings are illustrated in table 4.1 below. Even if all of the respondents have been selected from their belonging to one of the three groups of experts several of the respondents hold positions that qualify them as members of more than one group, which is illustrated by the x-marks of table 4.1. With reference to the group they were selected to represent in the first place, the x is printed in extra bold type.

---

<sup>17</sup> See chapter 8 for a suggestion of how a future research project could be designed to incorporate accountants/preparers and thereby contribute further to the knowledge created by this study.

<sup>18</sup> See Appendix 1 for a list of the 21 possible Swedish respondents and the 37 members of IASB’s SME group.

Interviews with accounting experts

Table 4.1 Accounting experts interviewed

Accounting Expert	Auditor	Academic	Standard Setter
Caisa Drefeldt	X		X
Hans Edenhammar	X		X
Robin Jarvis	X	X	X
Paul Pacter	X	X	X
Bengt Skough	X		
Per Thorell		X	
Bo Asell	X		

*Caisa Drefeldt* was initially chosen for this study because of her membership of *Bokföringsnämnden* and for taking an active part in the public debate on the development of accounting standards for SMEs. Caisa Drefelt is also an authorized public accountant with experience from working with accounting issues concerning growth-oriented SMEs.

*Hans Edenhammar* is the chairman of *Bokföringsnämnden* with experience from working as an authorized public accountant and former head of the Stockholm Stock Exchange's Surveillance Department. Hans Edenhammar's participation in this study is based on his quality as a standard setter and his active participation in the SME debate in the journal *Balans*.

*Robin Jarvis* is professor of accounting at Brunel University (UK), a member of the IASB's Panel for SMEs (representing the International Federation of Accountants, IFAC) and Head of SME Affairs at the Association of Chartered Certified Accountants (ACCA), United Kingdom. Robin Jarvis, who was selected for this study in his capacity of standard setter representing the IASB SME group, is also a certified public accountant and an active researcher in the field of financial reporting in SMEs.

*Paul Pacter* holds the concurrent positions as Director of *IFRS for SMEs* at the IASB and Director at the Global IFRS Office of Deloitte Touche Tohmatsu in Hong Kong. He also worked for the US FASB for 16 years. Paul Pacter, who is a Ph. D. and a certified public accountant, was initially chosen for this study because of his quality as a standard setter.

*Bengt Skough* is an approved public accountant with many years of experience of auditing in owner-managed SMEs, former SME-responsible at FAR SRS (the Swedish trade association for auditing and counseling) and presently (June 2009) additional/co-opted member of the management group of FAR SRS Small business sector. Bengt Skough has also for many years been a recurrent writer and debater on SME issues in the journal *Balans*.

Professor *Per Thorell* is a member of the staff of the Ernst & Young Technical Department in Stockholm and is associated to the Stockholm Centre for Commercial Law. Per Thorell is a former professor at Uppsala University and member of *Redovisningsrådet*.

*Bo Åsell* is an authorized public accountant and a member of the management group of FAR SRS Small business sector with extensive experience from working with growth-oriented businesses. Bo Åsell has also been engaged in the public debate on the development of accounting standards for SMEs.

#### 4.1.2 The interviews

Five of the interviews (Caisa Drefeldt, Hans Edenhammar, Bengt Skough, Per Thorell and Bo Åsell) were carried out during personal meetings, and two of the interviews (Paul Pacter and Robin Jarvis) were conducted on telephone. Before the interviews the respondents were e-mailed a short presentation of the research project together with the questions that have guided the discussions during the interviews (see Appendix 2). In order to secure that the discussions during the interviews centered on the concept *entrepreneurial SME* as defined in this study, the meaning of the term was presented both in the e-mails sent to the respondents in advance and when introducing the research project at the beginning of the interviews. Accordingly, the term entrepreneurial SMEs has been described to the respondents as the growth-oriented entities within the SME-group that are characterized by an eagerness to engage in new development projects and to exploit new product areas or markets, in order to take advantage of new business opportunities faster than competitors<sup>19</sup>. The significance of growth to this concept has been further concretized by referring to entities where the success of their managers' entrepreneurial mission has rendered them qualified for the label Gazelle (see section 2.3.1). The concepts related to the term entrepreneurship – such as growth, development projects and business opportunities – have also been recurrently referred to during the interviews in order to maintain the respondents' attention to the meaning of the concept of entrepreneurship as defined in this study.

During the interviews the respondents have been asked for their view on who the main users of entrepreneurial SMEs' financial reports are, for what decision-making purposes, or in what situations, they regard the information contained in entrepreneurial SMEs' financial reports to be of particularly relevant to the users; and what kind of financial reporting information they consider to be specifically important to the managers of entrepreneurial SMEs in their provision of information to the users (see Appendix 1 for the interview questions). In the literature study of previous empirical studies accounting

---

<sup>19</sup> See section 2.4 for a discussion on the definition of the concept of entrepreneurship.

#### *Interviews with accounting experts*

information on cash flow, intangible assets, and the division of costs into variable and fixed costs (contribution/contribution margin) was identified as likely to be of specific importance in an entrepreneurial context (see section 3.3 above). Therefore, concerning the question what constitutes significant financial reporting information in an entrepreneurial context the respondents have been asked not only for their general view on this issue, but also about the extent to which they consider information on cash flow, intangible assets, and the division of costs into variable and fixed costs, to be significant in an entrepreneurial setting. In addition, during the first interview the respondent put forward financial ratios measuring various aspects of growth as significant to managers of entrepreneurial SMEs in their provision of information to users, and because of the significance of growth to the concept of entrepreneurship as defined in this study, the other respondents were also requested to comment on the usefulness of growth ratios. Concerning decision-making purposes respondents have also been asked for their view of the usefulness of the information contained in the financial reports to management in their internal decision-making, which is an issue where the results of previous studies in the SME context diverge (see section 2.2 above).

#### ***4.1.3 Processing, interpreting and presenting the interview data***

All interviews were tape-recorded on permission of the respondents and transcribed verbatim after the interviews. The subsequent analysis of the transcriptions have centered on the two main issues of 1) the respondents' views on main users and purposes of financial reports and 2) what areas of financial reporting information that respondents consider to be of specific importance to managers of entrepreneurial SMEs in their provision of information to users. The aim of this analysis has been to find out the main themes of the respondents' views on these issues, and in section 4.2 below the results of this analysis is presented in accordance with the main themes sorted out.

## 4.2 Results of the interviews with accounting experts

### 4.2.1 Users and purposes of financial reports in the context of entrepreneurial SMEs

#### 4.2.1.1 Communicating with capital providers

All respondents put forward the continuous high demand for financial capital as a great challenge to managers of entrepreneurial and growth-oriented SMEs, and that the principal purpose of the use of financial reports in this context is to communicate with external capital providers. The financial reports make up an important informational role not only when new investments require new or additional financial capital but also to ensure the continued capital provision from existing financiers (e.g. Caisa Drefeldt, Bo Åsell). Among capital providers bankers are put forward by all respondents as the most frequent user group of entrepreneurial SMEs' financial reports. Further, all respondents believe that the continuously high demand for financial capital makes the extent to which entrepreneurial SMEs are financed by risk capitalists and other external owners greater than what is the case in SMEs in general. As suggested by one of the respondents, managers of entrepreneurial and growth-oriented SMEs might turn to risk capitalists not only because of the limited supply of funds from other sources but also to get access to the risk capitalists' expert knowledge of the area of business the company intends to explore (Bengt Skough). With reference to the use of financial reporting information two of the respondents, however, suggest that risk capitalists, as soon as they become owners of a business, usually get access to all information that is used in its internal management, and consequently the financial reports no longer make up their main source of information (Hans Edenhammar, Per Thorell). Nevertheless, in the initial phase of negotiation the financial reports make up a significant tool for informing risk capitalists about the financial position and prospects of the business (e.g. Caisa Drefeldt, Bo Åsell)

The financial reports are according to Caisa Drefeldt and Bo Åsell extremely important to managers of entrepreneurial SMEs in the process of acquiring the financial capital needed to secure the continuous growth of their entities. Bo Åsell also states that in order to provide a risk capitalist that is considering investing in the business with the relevant information, or if the entity is about to be valued at the prospect of a new share issue, a higher standard of the financial reports is required. Managers in such cases usually turn to professional advisors for assistance in the preparation of the financial reports (Bo Åsell). The financial reports make up a valuable starting point for an external

### *Interviews with accounting experts*

stakeholder considering investing in the entrepreneurial entity since they provide with the very important historic perspective of the business under evaluation (Bo Åsell). Even though the historical reports often are difficult to interpret, not least concerning newly started companies where the success of a business idea is not yet reflected on results, Bo Åsell believes that the information contained in the reports certainly constitute important and useful information together with additional information about such things as the business idea, the product and the market.

Bo Åsell and Bengt Skough also emphasize that managers of growth oriented and entrepreneurial SMEs generally are aware of the importance of providing capital providers with financial reports of high quality. According to Caisa Drefeldt the entrepreneurs themselves are not always aware of the significance of the financial reports but wise enough to turn to professional advisors who tend to the very important issues of financial reporting.

#### **4.2.1.2 Communicating with customers, suppliers and employees**

When asked for their view on which the main users of entrepreneurial SMEs' financial reports are, six of the seven respondents mention customers and suppliers. Even if customers and suppliers in general turn to credit rating agencies for the information needed to assess the credibility of a counter party (e.g. Per Thorell), there are situations when the credit rating information needs to be supplemented by financial reports. One such situation is when a transaction is of a considerable amount (Hans Edenhammar), another when the customer or supplier is dependent upon just one or a few other counter parties (Robin Jarvis). Yet another situation when a buyer or seller would like to assess the solvency of a potential counter party more thoroughly is when a contract involves large initial investments and when the profitability of the contract is contingent upon the continuous future deliveries/inflow of orders (Caisa Drefeldt, Paul Pacter). Caisa Drefeldt exemplifies the last mentioned situation with reference to a business that is about to order a new software system from a high-tech company. Due to the high costs of installing such a system the customer would certainly be interested in making an assessment on the probability that the delivering company will be around in a couple of years and also that it will have the capacity to deliver continuously. In such a situation, the financial reports of the supplier constitute an important source of information according to Caisa Drefeldt.

Employees make up another group of users who according to two of the respondents might have a specific interest in the financial reports of an entrepreneurial SME (Caisa Drefeldt and Paul Pacter). According to Paul Pacter it is very common in the United States that entrepreneurial SME employees are compensated in some kind of share-based payment. Because of

liquidity constraints it is in general not possible for high-tech and bio-tech research-oriented entities to pay the highest salaries to their employees, and in order to be able to compete with larger entities they may offer their employees equity share ownership in the entrepreneurial company as a compensation for a lower salary. In such companies, a pension is also often related to the success of the company, and it is certainly of interest to the employees to be able to assess the company's prospects of fulfilling the obligations when the pensions become due (Paul Pacter).

#### **4.2.1.3 Communicating with potential acquirers**

Three of the respondents put forward potential acquirers as an important user group of entrepreneurial SMEs' financial reports. With reference to his own experience, Robin Jarvis states that entrepreneurial and growth-oriented owner-managers in general plan for a future exit strategy already at the start-up of their businesses. In this respect, the financial reports make up an important tool for communicating the wellness of the business to competitors and other potential buyers. For this reason, Robin Jarvis states, the target-oriented entrepreneur is certainly keen on keeping his accounts in good order and to publish high-quality financial reports. As compared to what is usually the case in SMEs in general potential acquirers therefore make up an important user group of entrepreneurial SMEs financial reports (Robin Jarvis).

The common procedure among risk capitalists is according to Caisa Drefeldt to plan, already at the very beginning of their investment, for a future exit on a stock exchange. In the trade that precedes this exit, the financial reports make up a very important tool for communicating with investors (Caisa Drefeldt). Caisa Drefeldt further argues that the high quality requirements of the financial reports of a business that is to be noted on a stock exchange in general encourages tightly managed financial reporting procedures already in an early phase of the development of the entrepreneurial business.

Paul Pacter also states that it is very likely that entrepreneurial managers successful in managing the high growth of their entities eventually will introduce their companies to the public stock market, which is a procedure that requires "good financial numbers and supporting narrative information so that the investors who are putting in money into these companies can do it with their eyes open".

#### **4.2.1.4 The use of financial reporting information in the internal management**

Two of the respondents answered in affirmative to the question of whether financial reporting information is useful to the managers of entrepreneurial SMEs in their internal decision-making, which is an issue where the results of

### *Interviews with accounting experts*

previous studies in the SME context diverge (see chapter 2). Even though the close connection between the information contained in financial reports, on the one hand, and the information provided by internal management accounting systems, on the other, is attended to by the other respondents (e.g. Bo Åsell, Paul Pacter), the predominant view is that general purpose financial reports (balance sheet, income statement, cash flow statement, and notes) are marginally useful to managers of entrepreneurial SMEs in the internal management of their businesses. Five of the interviewed accounting experts believe that managers find their information for internal decision-making mainly from other sources than financial reports. According to Bo Åsell the information used by management in the evaluation and follow-up of new development projects comes mainly from the internal management accounting system. With reference to previous studies, including his own research, Robin Jarvis argues that financial reports in general are used for internal decision-making purposes to greater extent in smaller businesses than in larger ones. In the smaller entities within the SME continuum the main users of the financial reports tend to be the owner-managers in general, while other users become more important in larger entities. In entrepreneurial and growth-oriented SMEs, Robin Jarvis continues, the financial reports tend to be of less use for making decisions within the business and managers tend to orient their use of the financial reports to the communication with external actors.

Paul Pacter maintains that the financial reports provide with important information on “the big picture of the company”, trends and long-term profitability to managers of entrepreneurial SMEs. In all that, Paul Pacter states, the general purpose financial reports are not designed to produce sufficient management information such as more detailed information about profitability by product line or segment. Also, while financial reports mainly attend to historic information about past events and transactions – which is important from a management perspective but not sufficient - management decisions usually involve forecasts that are not included in the financial reports. Examples of questions that according to Paul Pacter will not be answered by means of financial reporting information are: “What business areas are potential for growth and what areas are declining?” or “Is the continued operation of a specific factory profitable in the future, or should the production equipment be rented or owned?”

Both Caisa Drefeldt and Bengt Skough, however, consider the information contained in the financial reports to be an important tool for internal management purposes and points to the importance of financial reports in confirming the management accounts. Financial reporting information is according to Bengt Skough crucial in the processes of budgetary follow-ups in general, and – because of the great importance of keeping track of liquidity in growing entities - in the management of liquidity in specific. Bengt Skough also

believes that there is a greater awareness of the usefulness of the financial reports as a tool for internal decision-making among SME-managers with ambitions for growth and development than among managers of SMEs in general.

Caisa Drefeldt draws attention to the legal demands for a certain level of share-capital that are critical to the continued existence of the reporting entity, and therefore of crucial importance to its management. Since the Swedish bankruptcy legislation is aimed at the information contained in the financial reports, the management accounts will not provide with the relevant information needed by the management of an entity that is close to being forced into liquidation (Caisa Drefeldt).

#### 4.2.1.5 Summary

Table 4.2 presents a summary of the view held by the accounting experts concerning the main users of entrepreneurial SMEs' financial reports. According to the interviewed accounting experts, the main user groups of entrepreneurial SMEs financial reports include financiers – mainly bankers but also risk capitalists and other external owners – customers, suppliers, employees and potential acquirers. Concerning the internal use of financial reports by managers, two of the respondents consider financial reporting information to be valuable to managers for internal decision-making purposes. Even though several of the other respondents put forward the close connection between management accounting information and financial reporting information, the opinion among the majority of the respondents is that management finds their information for internal purposes mainly from other sources.

Table 4.2 Users of entrepreneurial SMEs' financial reports

Accounting Expert	Bankers	Risk capitalists	Customers & suppliers	Other external owners	Potential acquirers	Employees	Management
Caisa Drefeldt	X	X	X	X	X	X	X
Hans Edenhammar	X	X	X				
Robin Jarvis	X	X	X		X		
Paul Pacter	X	X	X	X	X	X	
Bengt Skough	X	X	X				X
Per Thorell	X	X	X	X			
Bo Åsell	X	X		X			

## 4.2.2 Financial reporting information of certain importance in an entrepreneurial context

### 4.2.2.1 Cash flow

All respondents consider financial reporting information on cash flow to be particularly relevant in the context of entrepreneurial SMEs. “Hard facts” (Per Thorell, Bo Åsell), “the most important statement of the financial reports” (Caisa Drefeldt), and “an underrated tool for control” (Bengt Skough), are examples of designations ascribed to information on cash flow by the interviewed accounting experts. By providing investors with the very important information on how the cash flow of an entity has been generated, the cash flow statement makes according to Caisa Drefeldt up the most essential part of the financial reports. Examples of questions revealed by the cash flow statements in this respect are: “Has the cash been generated internally by the sales of the company’s products or services?”, or “Are there continuous deficits from operations that have been compensated by contributions from financiers or the selling off of assets - implying that the company is in fact bleeding?” (Caisa Drefeldt).

Bo Åsell gives prominence to the merits of cash flow not at least in the evaluation of businesses in their early stages of development, or businesses that are in the early research phase of a development project. In such companies, the balance sheet gives in general a somewhat weak image of the business and investors tend to turn to cash flow statements in order to get the “hard facts” of the prospects of the business:

*...[a business plan] may be as gorgeous as ever, but you also need to know what is actually happening and then, it is my opinion, cash flow is what first of all shows how [the business] is coming along...* (Bo Åsell)

Bengt Skough considers the cash flow statement to be an underrated tool for control that should be required for all companies, not just larger and/or publicly held ones. Hans Edenhammar also states that it is somewhat unfortunate that there is no requirement for smaller companies to publish cash flow statements. Even so, Bo Åsell continues, it is common practice in entrepreneurial SMEs with high ambitions to grow to incorporate cash flow statements in the financial reports even if there is no such requirement by law.

Cash flow information is according to Hans Edenhammar of specific importance in high-growth entities not only because of the importance to keep track of the demand for financial capital but also since the greatest differences between profit and cash flow in general occur in this group of entities. The cash flow statement will also very clearly illustrate potential financial difficulties

of an entity that is growing too quickly (Hans Edenhammar). Furthermore, Per Thorell argues that the extent to which entrepreneurial entities often rely on intangible investments, which are not sufficiently reflected in the general purpose financial reports, makes cash flow superior as performance measurement.

A consequence of a regulation with no requirement for SMEs to publish cash flow statements is according to Paul Pacter that external users will construct such statements on their own. Even so, Paul Pacter, as well as Hans Edenhammar, expresses some skepticism towards the competence of external users in this respect. Even though it is possible for external users to reconstruct cash flow statements from the information contained in two balance sheets, an income statement and a few more pieces of information such as dividend payments, there would certainly be some guesses in such statements (Paul Pacter). With reference to the entrepreneurial entities in the SME context, however, the common practice among users in general, and bankers in specific, is according to Paul Pacter to request cash flow statements to be included in the financial reports.

Robin Jarvis believes that cash flow information is very important but raises some doubt against the custom practice to report on cash flow of the past. It is noticed, however, that even if users would benefit from cash flow predictions rather than historic reports, there might certainly be a hesitance among managers to disclose information that would provide users with information on delicate matters that should remain business secrets (Robin Jarvis). Robin Jarvis also criticizes the disposition of the cash flow statement required under the draft *IFRS for SMEs* of being too complicated and therefore requests statements produced in a more sympathetic way that is easier for users to understand:

*“Perhaps there should be a reassessing of what users want in terms of cash flow historic statements.” (Robin Jarvis)*

#### **4.2.2.2 Intangibles**

All respondents consider information on intangible assets to be of particular importance in the context of entrepreneurial SMEs. Apart from the legal aspect, which certainly may be critical to the continuing existence of a company (Caisa Drefeldt, Hans Edenhammar, Bengt Skough), the respondents are uncertain about the consequences of not having investments in intangible resources capitalized as assets in the balance sheet of the entrepreneurial entity. Concerning the informational aspect of capitalization, however, the predominant view is that disclosure of information on intangible investments

### *Interviews with accounting experts*

makes up a fully conceivable/relevant option (Caisa Drefeldt, Bo Åsell, Hans Edenhammar, Per Thorell, and Paul Pacter).

Both Caisa Drefeldt and Paul Pacter argue that an investment in intangible resources that meets the definition of an asset, and is possible to measure reliably in terms of value, should be recognized as such. In cases when capitalization of an intangible investment is not an option, good additional disclosed information on the investment is vital (Caisa Drefeldt, Paul Pacter). When the law restricts capitalization, or if the company chooses not to do so in prudent precaution, the disclosed description should according to Caisa Drefeldt include information on the reason for the decision not to capitalize to avoid sending unjustified signals to users that there is an uncertainty concerning the prospects of the investment. Furthermore, narrative descriptions of development projects are according to Caisa Drefeldt not only important when the accounting regulation prohibits capitalization, or when the reporting entity for some reason have chosen not to capitalize the expenses for intangibles, but also as complementary information to intangible assets that are capitalized (Caisa Drefeldt).

Concerning development projects that have been capitalized as assets, Caisa Drefeldt argues for additional disclosure on the estimated lifetime of the project and the reasons for the choice of depreciation period. If the depreciation period of a specific asset for instance is very long, information should be disclosed on the reasons for the choice of depreciation period together with an estimation of the probability that the development project will generate revenues during the estimated useful life of the asset. On the other hand, if a capitalized intangible asset has not yet been depreciated, it is significant to disclose the reasons for such a strategy. Concerning capitalized development projects Caisa Drefeldt also argues that it is important to disclose information on the components of the capitalized asset, i.e. the expenses included in the capitalized amount.

It is suggested by several of the respondents that the disclosed information on research and development projects should include not only the amount of resources that has been invested in research and development, but also a description of the expected future development of the projects (Caisa Drefeldt, Per Thorell, and Paul Pacter). To avoid revealing business secrets to competitors it is according to Caisa Drefeldt significant that the future expectations of ongoing projects are described in general terms. With respect to the expected future development of intangible projects Caisa Drefeldt further maintains the significance of cash flow information:

*“... then it is all about cash flow. Anything else is completely uninteresting.”  
(Caisa Drefeldt)*

Paul Pacter draws attention to the circumstance that high-tech companies in general rely on human capital in terms of knowledge and technical skills to a considerable extent and in his opinion information on the access to such human capital should be included in the disclosed information in addition to the information on product-related intangibles.

With reference to his own research, Robin Jarvis states that growth-oriented and entrepreneurial SMEs in general rely to a great extent upon intangible resources, and he is critical to the way in which financial reports fail to display such assets which he argues restricts the availability to financial capital. According to Robin Jarvis, there is a trend towards supplementing the quantitative numbers with descriptive accounts:

*"[Concerning intangibles] I think there is a case in using the descriptive things [rather] than using quantitative things. I am not as convinced anymore that the quantitative ways for financial reporting captures what the business does, how well the business is performing." (Robin Jarvis)*

In all that, Robin Jarvis believes that the issue of whether there is a need to capitalize intangible investments as assets, or if it is sufficient to describe such investments in narrative form, has not yet been inquired properly into:

*"I think it is of great importance, and we haven't addressed the issue. Financial reports, in my view, do not reflect business reality." (Robin Jarvis)*

With reference to the, at the time for the interviews, forthcoming Swedish accounting standard for limited liability companies (K2), Bo Åsell cautions that the prohibition to capitalize investments in internally generated intangible resources will not be seriously detrimental to the entrepreneurial entities belonging to this group. According to Bo Åsell it would be in line with the growth-orientation of such entities to choose to comply with K3 even if they at the moment are of K2-size, since they eventually - if successful in their efforts to grow - will end up in the size of K3, or even K4. Even so, Bo Åsell believes that the very possibility to capitalize internally generated intangible assets may contribute to the decision to go for an accounting standard aimed at larger entities (K3 or K4 in the Swedish context). Caisa Drefeldt and Hans Edenhammar also believe that K3 will be the primary choice for entrepreneurial entities of K2-size, partly for the possibility to capitalize internally generated intangible assets.

#### 4.2.2.3 Financial ratios

The majority of the respondents consider financial ratios of various kinds to be of specific interest regarding entrepreneurial SMEs. Hans Edenhammar, to start with, strongly supports the use of financial ratios in general, and ratios on sales

### *Interviews with accounting experts*

and growth in specific, for entrepreneurial and growth oriented entities. In line with Hans Edenhammar, Bengt Skough also believes that financial ratios are an underrated tool for financial control that should be used to a greater extent by companies than what is the case today.

On the question of whether information on ratios makes up significant financial reporting information in the context of entrepreneurial SMEs, Paul Pacter responds:

*“Wearing my hat as a standard setter, it is beyond our expertise. If I was one of the users, I would say I would like to have information on those ratios for my decision-making, I would even like to have a standard for how those ratios were calculated.” (Paul Pacter)*

Financial ratios are according to Bo Åsell used by analysts to a great extent in the evaluation of entrepreneurial businesses, and in this respect analysts are explicitly interested in industrial-specific financial ratios and ratios measuring various aspects of growth. For entities that have been in business more than just a few years it is according to Bo Åsell significant to communicate to users that previous targets of growth have been reached continuously and in this respects financial ratios provide with important information.

According to Hans Edenhammar and Per Thorell there is an increasing tendency among financiers - especially risk capitalists - to include covenants in their contracts, which means that the continued provision of financial capital is contingent upon the fulfillment of some preset requirements often expressed in the form of financial ratios. A credit contract may for instance include a covenant regarding solvency, implicating that the loan expires if the solidity falls below a certain level (Hans Edenhammar). According to Per Thorell there is an increasing trend among creditors to incorporate covenants in credit contracts with entrepreneurial entities in specific, which makes information on financial ratios even more important in the entrepreneurial context.

In Per Thorell's opinion financial ratios are in general harder to interpret in the context of entrepreneurial and growth-oriented businesses than what is the case concerning non-growing businesses. “When it comes to entrepreneurs, standardized solutions are out of order”, Per Thorell argues and further requests accounting solutions that are adapted to the specific circumstances of the individual entities. To the question of the importance of growth ratios in specific Per Thorell however replies that such ratios of course provide with important information in an entrepreneurial context, and Caisa Drefeldt, Robin Jarvis and Paul Pacter express equivalent standpoints. Paul Pacter however argues that if financial reports contain sufficient historical information it is not difficult to calculate growth ratios. Even though Bengt Skough points out that

he has limited experience in the use of growth ratios in entrepreneurial and growth-oriented SMEs in specific, it is a matter of course that such information is of high interest concerning this group of entities. Caisa Drefeldt attends to the importance of industry specific ratios and makes a reference to the consulting industry where it is significant to measure growth in sales and profit (and profitability) in relation to employees.<sup>20</sup>

#### 4.2.2.4 Other disclosed information

Several of the respondents consider additional disclosure to be particularly important in the entrepreneurial context (Per Thorell, Robin Jarvis, Paul Pacter), and that the trend is towards more disclosure in the future, especially concerning entrepreneurial-oriented entities (Per Thorell, Robin Jarvis). According to Paul Pacter there is a lot non-financial information that may be even more important in the entrepreneurial SME than the numerical financial information:

*“Every company has to tell their story. Accounting numbers is just a part of the story, there is a lot more that they must tell besides accounting numbers”... (Paul Pacter)*

Besides the suggestion to disclose narrative information on intangibles (section 4.2.2.2) and growth ratios (section 4.2.2.3), the majority of the respondents give suggestions of other additional disclosure<sup>21</sup> that they believe to be of specific importance in the entrepreneurial context. In this respect three of the respondents have mentioned the importance of disclosed information on aspects related to the business concept of the reporting entity. Paul Pacter mentions information on the technology of the entity's products and information about the market in this respect. Bo Åsell argues for the importance of providing information on the business concept of the reporting company – its products and its services – and to supplement the numerical numbers of cash flow and turnover with descriptions of the marketability of the business concept. Caisa Drefeldt maintains that it is significant that the financial reports of the entrepreneurial SME incorporates a description of “what you are doing” and also, in broad outline and without revealing business secrets, a description of the expected development of the projects carried out by the entity, together with the arguments behind these expectations.

Three of the respondents consider additional disclosed information on liabilities to be of specific importance to the users of entrepreneurial SMEs'

---

<sup>20</sup> Bengt Skough argues for the importance of industry-specific accounting information in general.

<sup>21</sup> Information provided in addition to the standardized general purpose financial statements (income statement and balance sheet).

### *Interviews with accounting experts*

financial reports. In this respect, Hans Edenhammar stresses the importance of additional disclosure of information on loan promises, expiry dates and covenants (see section 4.2.2.3 above) connected to the loan agreements. Per Thorell also argues for the importance of transparency in terms of loan structure and the conditions/terms of the different loan agreements, not at least when there are more than just a few actors providing finance to the entrepreneurial entity. Robin Jarvis requests a greater focus on liabilities in the financial reports of entrepreneurial SMEs financial reports, and in this respect he considers information on leasing contracts to be of specific interest to users.

Besides transparency in terms of liabilities Per Thorell also requests disclosed information on dividends and compensations to management which he believes to be of specific importance in the context of entrepreneurial SMEs. Paul Pacter states that it is important to disclose information on items that have been charged directly to equity and therefore do not show up in the income statement<sup>22</sup>.

On the asset side of the balance sheet, Robin Jarvis specifically requests additional disclosure on outstanding debtors – “how long they are and how old they are” - of the entrepreneurial and growth-oriented SME, since such information should be of high value to financiers in their assessment of possible future cash flow problems of the reporting entity.<sup>23</sup>

With reference to the income statement, Per Thorell maintains that the very general principles for measuring revenues signifies the disclosure of information on the methods applied when calculating the revenues; this in order to inspire the users of the entrepreneurial entity's financial reports with confidence in the reliability of the item. Furthermore, by supplementing the numbers presented in the income statement with additional information about the contracts that the reported entity has entered into with customers will provide the users with significant information in their evaluation of the substance of the revenues accounted for (Per Thorell). The importance of disclosing information on the contracts that the revenue number is based upon is also attended to by Bo Åsell.

Hans Edenhammar notes that since privately-held entities do not have to conform to the regulation on insider trading that is imposed on publicly-held entities; the need of disclosure is not as extensive in the first mentioned group

---

<sup>22</sup> Examples of items charged directly to equity are dividends, new share issues, revaluations of some assets (IAS 16), changes in value of some financial instruments (IAS 39), purchases and sales of own shares (IAS 32).

<sup>23</sup> Concerning assets, Paul Pacter argues for the importance of fair value information, particularly regarding financial instruments, implicating the use of future cash flow information.

as in the latter. When a stakeholder to a privately-held SME requests comments or clarifications on items of the financial reports it is possible to obtain such information in an uncomplicated way. In all that, Hans Edenhammar believes that financial reports of non-public entities in general are too formal, and he requests specifically more information on why different items of the financial reports have developed the way they have, and, also, what items that are occasional and what items are recurrent. In Hans Edenhammar's opinion, the financial reports of non public-entities in general, and of high-growth entities in specific, usually provide with insufficient information on these issues, which are of great importance to the evaluation of the financial position and the prospects for the future. The financial reports of high-growth entities often "do not make it out", Hans Edenhammar continues; you see the on-the-spot account at the end of the accounting period, and the development of the turnover, but rather than answering the questions the user might have concerning the development of different items, the numbers often raise additional questions.

#### **4.2.2.5 Contribution margin**

In the literature study of previous studies of accounting in entrepreneurial contexts information on contribution margin was sorted out to be of specific importance by entrepreneurs in their internal management of their businesses. During the interviews with accounting experts the respondents were asked for their view of disclosing information on contribution margin to the financial reports of entrepreneurial SMEs, and, also, of an alternative tentative contribution-oriented disposition of the income statement where the cost part is divided into fixed and variable costs.

The idea of disclosing information on contribution margin did not gain any support to talk of from respondents; neither has the tentative idea of an alternative disposition of the income statement where the cost part is divided into fixed and variable costs (except for Robin Jarvis who mainly talks about very small businesses in this respect). Bo Åsell states that he has experienced an interest among entrepreneurs in an alternative contribution oriented income statement, but in his own opinion the possibility to disclose information on contribution ratios is sufficient. Hans Edenhammar believes that contribution margin is a useful tool for the internal management but he is rather skeptical concerning the external users' interest in such information (Hans Edenhammar however suggests that I ask the users themselves). According to Caisa Drefeldt the issue of providing information on contribution margin is irrelevant since such a disclosure would involve too much exposure of trade secrets.

#### **4.2.2.6 Summary**

Table 4.3 below illustrates the areas of financial reporting information that two or more of the interviewed accounting experts considered to be of specifically

*Interviews with accounting experts*

important to managers of entrepreneurial SMEs in their provision of information to users. The respondents consider financial reporting information on especially cash flow, intangible assets – capitalized or in narrative form – and growth ratios, to be of specific importance in the entrepreneurial context. All respondents also provide suggestions of additional disclosed information and in this respect information on business concepts, information on liabilities and contracts with financiers, and additional information on sales/revenues has received the most attention. The idea of disclosing information on contribution margin, that in the literature study of previous empirical studies about accounting in entrepreneurial contexts was sorted out as useful to entrepreneurs for internal decision-making purposes (chapter 3), did not receive any support to talk from the interviewed accounting experts.

**Table 4.3 Significant areas of financial reporting information according to the interviewed accounting experts**

Accounting expert	Cash flow	Intangible assets	Growth ratios	Business activities (disclosure)	Liabilities (disclosed)	Revenues (disclosed)
Caisa Drefeldt	X	X	X	X		
Hans Edenhammar	X	X	X		X	
Robin Jarvis	X	X	X		X	
Paul Pacter	X	X	X	X		
Bengt Skough	X	X	X			
Per Thorell	X	X	X		X	X
Bo Åsell	X	X	X	X		X



## 5 Document study of comment letters to BFN's K2 drafts

In June 2008 *Bokföringsnämnden (BFN)* approved the general advice of *Financial reporting in small companies (K2)* to be optionally applied on financial reports drawn up on December 31, 2008, and onwards. By including limited companies with less than 50 employees, less than €2,5 million in assets and a net turnover of less than €5 million the K2 category aims at enterprises that in terms of size make up the smaller part of the SME group as defined in this study. As a part of the process of developing the final accounting standard for K2, drafts were referred for consideration on two occasions, in February 2006 (BFN, 2006a), and in February 2007 (BFN, 2007). This chapter presents the mode of procedure and results of the document study of comment letters to the two K2 drafts.<sup>24</sup>

### 5.1 Mode of procedure

The first K2 draft of 2006 was referred to 27 instances and 32 comment letters were received. When the same respondent has handed in more than one comment letter, the documents from this respondent have been interpreted as a single comment letter, and after adjusting the total number of comment letters for two such cases the total number of comment letters amounts to 29. This number has been reduced to 27 after adjusting for two comment letters that include only the statement that no comment will be made. To the second draft of 2007, which was referred to 42 instances, comment letters were received from 35 respondents, and after reducing this number by the six “no comment” letters, the number of relevant comment letters amounts to 29. Consequently, a total of 56 (27 + 29) comment letters have been included in the document analysis presented in this chapter.

All of the 56 comment letters were scanned with the aim of finding sections where users and purposes of financial reports, and items of financial reporting information, are discussed in relation to general entrepreneurship terms such as entrepreneur, growth and innovation. This scanning through of comment letters has also included a search for comments on the specific areas of financial reporting information that have been identified in the literature study of previous studies on accounting in entrepreneurial contexts (chapter 3), and expert interviews (chapter 4), as significant in an entrepreneurial setting, i.e. cash flow, intangible assets, growth ratios and contribution margin. The survey

---

<sup>24</sup> The document study of the K2 comment letters was carried through during early autumn 2008.

of documents resulted in the identification of a total of 21 comment letters where the discussions of relevance to this study exclusively focus on the proposed regulation concerning accounting for internally generated intangible assets. The respondents to the 2006 draft returned in several cases in 2007 with identical or as good as identical comments, or the statement that the 2006 comment was maintained, which does not come as a surprise considering that no changes were made concerning the treatment of internally generated intangibles in the 2007 draft as compared to the 2006 version. Such recurrent comment letters by the same respondent have been interpreted as a single document, leaving a total of 17 documents to analyze in this part of the study. The authors of these documents represent professional accountants, accounting and auditing firms, trade organizations, government authorities and academic institutions (see Appendix 3 for a list of the structure of respondents in terms of organization categories).

The document study presented in this chapter sets out from the assumption that the representatives of the organizations to which the proposed accounting standards for smaller companies (K2) were referred for consideration hold expert knowledge of issues related to accounting in the SME-context. In the process of carefully reading through the comment letters sorted out one comment letter was found where the respondent bases his comment on the conclusions of his bachelor thesis. Since the argument provided in this comment letter is in line with one of the most frequent arguments put forward by the other respondents – and thereby do not change the conclusions of the document study as a whole to any appreciable extent – this comment letter is not excluded from the analysis (see footnote number 16 on page 45 below). Eight of the remaining 16 documents have been written by auditors/advisors which makes this group the predominant category of authors to the comment letters that has been sorted as being of immediate interest to this study. Out of the other eight documents four have been authored by representatives of trade associations, two by government authorities and yet another two by academics.

The relevant discussions of the 17 comment letters sorted out for this document study have been carefully read and categorized according to the opinion put forward regarding the treatment of internally generated intangible assets, and this categorization provides with structure to the presentation of the results in section 4.2 below.

## **5.2 Results of the document study**

In both the 2006 and 2007 drafts of K2, the possibility of previous regulation to capitalize investments in internally generated intangible resources as assets in the balance sheet is removed. In two of the comment letters sorted out for this

*Document study of comment letters to K2 drafts*

document study, this suggestions is supported with the argument that internally generated assets are more risky than other items of the balance sheet and also very complicated to evaluate (the Swedish Tax Authority, 2006), and that a removal of internally generated intangible assets from the balance sheet would facilitate the credit rating process (SRF, 2006).

The 15 documents that contain negative criticism towards the suggested prohibition to capitalize investments in intangible resources have in table 5.1 below been categorized according to the focus of the arguments provided (note that the same respondent may have put forward more than one argument and thereby ends up in more than one category). It has not been possible to discern any significant pattern of the arguments depending on what category of respondents (accounting firms, trade associations etc) the authors belong to. In two of the comment letters no argument for the opposition towards the suggested accounting solution is presented, and in the following the main arguments of the remaining 13 documents will be presented.

Table 5.1 Arguments against the suggested K2 regulation concerning internally generated intangibles

Argument Respondent <sup>25</sup>	Balance sheet for liquidation purposes	Increased administrative burden	Restructuring of development projects	Less relevant information to users	Prevention of development projects	No specific argument provided
Företagarna (2006, 2007)		X		X	X	
Sydsvenska Industri- och Handelskammarens redovisn. kommitté (2006)	X					
S-I. Danielsson (2006, 2007) <sup>26</sup>		X				
KPMG (2006, 2007)	X	X	X	X		
L. Nilsson, S-I. Danielsson & C. Stavegren (2006, 2007)	X	X	X	X	X	
Svenskt Näringsliv (2006)		X	X		X	
Revisorsamfundet (2006)	X	X	X	X	X	
LRF (2006)						X
FAR (2006)	X					
FAR SRS (2007)						X
SRF (2007)			X			
Gothenburg School of Economics (2007)	X	X	X	X		
Företagsrevision Cederlund/Grabe (2007)		X	X			
S-E. Ingblad & P. Lundqvist (2007)	X					
J. Bornhager (2007) <sup>27</sup>	X					

<sup>25</sup> The indication of (2006, 2007) means that the respondent has returned in 2007 with identical or as good as identical comments as presented in their comment letter to the 2006 draft.

<sup>26</sup> Even though S-I. Danielsson co-authored the comment letter by L. Nilsson, S-I. Danielsson & C. Stavegren, he has provided with an individual comment letter that includes comments that is not identical to the content of the collective comment letter/the comment letter of the group, and thereby the individual comment letter by S-I. Danielsson is included in the analysis.

<sup>27</sup> J. Bornhager bases his comments on the conclusions of his bachelor thesis.

### **5.2.1 The need to set up a balance sheet for liquidation purposes**

A frequent argument against the suggested prohibition to capitalize investments in intangible resources, which is put forward by eight of the 15 respondents, is the legal consequences of the negative effect that an obligation to write off the expenses for investments in intangible resources may have on the share capital of the reporting entity. According to Swedish law, limited liability companies are required to set up a balance sheet for liquidation purposes when half of the registered share capital is used up. Then, there is a time limit of eight months within which the share capital has to be completely restored; otherwise the company is forced into bankruptcy. Consequently, for development intensive companies with continuous investments in internally generated intangible resources the suggested solution of the K2 drafts may have far-reaching consequences (e.g. *Revisorsamfundet*, 2006).

### **5.2.2 Increased administrative burden and restructuring of development projects**

One way to avoid the reduction of share capital and the consequent requirement to set up a liquidation balance sheet, and the subsequent risk of being forced into bankruptcy, is to apply a more complex regulation that allows capitalization of investments in internally generated intangibles. The alternative offered by the Swedish accounting regulation in this respect will be in the form of the coming accounting standard for K3 entities. If the K3 accounting standard is chosen the reporting entity must follow this regulation in its entirety, not only regarding the reporting of investments in internally generated intangible assets. According to seven of the 15 respondents, however, this alternative do not legitimize the suggested prohibition of capitalization of internally generated intangible assets of K2, since this would bring about *increased administrative burdens* for those entities that on all other aspects are content with the simplified regulation of K2.

Another way to evade the prohibition to capitalize internally generated intangible assets, which is put forward in seven of the comment letters as a likely consequence of the suggested regulation, is for the reporting entities to find new ways to *restructure development projects*. As described in the comment letter of Gothenburg School of Economics (2007) the reporting entity may start up a completely new business where the research and development projects are carried out. Later on, when this new business is acquired by the primary company, the acquisition contract will make it possible to include the acquired investments as assets in the balance sheet of the primary/principal company. The representatives of *Svenskt Näringsliv* (2006) who also put forward the formal

reorganization of development projects as a likely consequence of a more restrictive regulation concerning internally generated intangible assets as compared to the acquired equivalents, maintain that such a procedure would bring about nothing but unnecessary costs for the reporting entities (*Svensket Näringsliv*, 2006).

### 5.2.3 Less relevant information to users of financial reports

The consequences of the suggested regulation concerning internally generated intangible assets on the informational value of financial reports are mentioned in five of the analyzed comment letters. It is suggested that a prohibition to capitalize such investments as assets would lead to the provision of less relevant information to users of financial reports, among which capital providers are considered to hold a prominent position (*Revisorsamfundet*; Nilsson, Danielsson & Stavegren; KPMG). According to representatives of *Revisorsamfundet* (2006) a very important purpose of the financial reports of smaller entities is to provide financiers with information for credit ratings and credit decisions. The suggested prohibition to capitalize such assets will in this respect lead to the provision of less relevant information for such decisions, which in turn may bring about a shift between different forms of credit, such as the increased use of leasing (*Revisorsamfundet*, 2006).

The sustained provision of financial capital is according to Nilsson, Danielsson and Stavegren crucial to newly established innovation and development intensive companies in their efforts to reach the market and to expand. To these companies a possibility to capitalize internally generated intangibles is critical since losses that originate from expensed development costs decreases the confidence in the reporting entity concerning the prospects to survive and continue to develop its innovations. In addition, a requirement to write off expenses for further development of innovations – as suggested in the drafts of K2 – creates further losses for the reporting entity that need to be covered by additional financial capital, often in the form of risk capital. Nilsson, Danielsson and Stavegren further maintain that the possibility for innovative entities to raise finance is rendered even more difficult by the circumstance that risk capitalists and business angels in general require that the balance sheet of an innovation company considered for investment is without deficits for a period of three years before the investment

The representatives of Gothenburg School of Economics refer in their comment letter to previous research when maintaining that financial reports of entrepreneurial entities are not only used to inform external users but, for reasons of cost efficiency, play a significant role in the internal management of the business as well. The proposed regulation concerning intangibles is in this

context considered to lead to the provision of less relevant information to entrepreneurs managing innovative businesses.

#### 5.2.4 Prevention of development projects

In the 2006 comment letter authored by representatives of the trade association *Företagarna* it is argued that the lack of access to risk capital restrains the development of smaller businesses, not at least with respect to entities that are in the early phase of developing their businesses. An accounting regulation that prohibits capitalization of intangibles will lead to an increasing need for risk capital to fulfill the legal demands for a minimum level of share capital, with the consequence that the development of new ideas and products is obstructed (*Företagarna*, 2006). Therefore, the representatives of *Företagarna* maintain, it should be allowed to distribute the expenses for research, development and marketing over several years by activating such investments as assets.

Several of the respondents argue that the possibility to capitalize expenses for internally generated intangible assets is especially critical to growth-oriented and development intensive business and that the suggested regulation would have a restraining effect upon the development and lead to that many innovations would never come about (Nilsson, Danielsson & Stavegren; *Företagarna*; *Svensket Näringsliv*; *Revisorsamfundet*). Considering the role of knowledge-intensive businesses to the development of the economy as a whole such a scenario is also believed to bring about severe consequences not only for the reporting companies but also for the development of society at large (Nilsson, Danielsson & Stavegren; Gothenburg School of Economics; *Företagarna*). Even if the entities where it is critical to capitalize intangible investments such as research and development costs only make up a smaller part of the SME group, it is noticed in the comment letter by *Företagarna*, such entities are certainly important from the perspective of the growth of the economy.

The representatives of *Svensket Näringsliv* also maintain that the suggested treatment of internally generated intangibles would counteract entrepreneurs that are about to further develop high-potential projects, which in turn would lead to the obstruction of the enterprising spirit of the economy. Furthermore, Nilsson, Danielsson & Stavegren draw attention to the importance of the establishment of new innovation and development intensive companies in creating new productive job openings/opportunities, and that the success of smaller entities is the most significant growth factor within the Swedish economy. The supply of licensed technology from smaller development intensive companies is also considered to be critical to the competitiveness of larger companies (Nilsson, Danielsson & Stavegren).

### **5.2.5 Summary of results**

According to the proposed regulation for K2-companies it is prohibited to capitalize investments in internally generated intangible resources as assets in the balance sheet, a solution that all respondents except the Swedish Tax Authority and *SRF* (2006) raise objections to. The most frequent argument against such a prohibition is that it may create a need for many companies to set up a balance sheet for liquidation purposes with the consequent risk of being forced into liquidation. To avoid the requirement to write off development costs directly to profit, the reporting entities will pursue different strategies, including the choice to comply with a more complex accounting standard (K3 in the Swedish context) or to restructure their development projects. Such procedures are by the respondents considered not only to counteract the aim of simplification of the accounting regulation, but also to impose indefensibly high administrative costs on reporting entities.

Several of the respondents to the K2 drafts also maintain that the suggested prohibition to capitalize internally generated intangible investments will result in the provision of less relevant information to users of financial reports. The suggested regulation is also considered to have a detrimental effect on development intensive companies' access to financial capital, with the accompanying risk that many companies with potential to succeed with their development projects will not carry through such projects. This in turn is not only considered to be detrimental to the individual companies carrying out the projects, but to the development on the societal level as well.

## 6 Document study of comment letters to the IASB draft *IFRS for SMEs*

As a part of the process of developing the *IFRS for SMEs*<sup>28</sup> the IASB published an *Exposure Draft* of an *IFRS for SMEs* (IASB, 2007) in February 2007. The draft received comments from 161 respondents including professional accountants, auditors, representatives of accounting and auditing firms, trade organizations, government authorities and academic institutions. Even though the respondents were not asked to comment on the information needs in the context of entrepreneurial SMEs specifically, which is the focus of this study, the comment letters provide with relevant data for several reasons. Firstly, in the literature study of previous studies about accounting in entrepreneurial contexts (chapter 3) as well as in the expert interviews (chapter 4) information on cash flow was sorted out as significant in an entrepreneurial context. Since the exposure draft includes a requirement for SMEs to publish a cash flow statement, and the respondents were explicitly requested to comment on this suggestion, the comment letters are certainly of interest to this study. Secondly, information on intangible assets was identified as significant in an entrepreneurial context in all the previous steps of data collection – i.e. the literature study (chapter 3), the expert interviews (chapter 4) and the document study of comment letters to the K2 draft (chapter 5). Since the *Exposure Draft of an IFRS for SMEs* includes an option for reporting entities to choose to either capitalize or expense their development costs, the respondents' comments on this issue are also of high interest to this study.

This chapter presents the document study of comment letters to the draft *IFRS for SMEs*.<sup>29</sup> The aim of this step in the data collection has been to sort out comments where items of financial reporting information are discussed in relation to the context of entrepreneurial SMEs, both in general and concerning the areas of financial reporting information that have been identified in the previous steps of data collection conducted within this study (chapter 3, 5 and 5) - i.e. cash flow, intangible assets, growth ratios and contribution margin - in specific. This chapter firstly presents the mode of procedure for the sorting out and analysis of the comments that are relevant to the study and, thereafter, the results of the document study are presented.

---

<sup>28</sup> The final standard *IFRS for SMEs* were published in July 2009 (IASB, 2009).

<sup>29</sup> The document study of the comment letters to the draft *IFRS for SMEs* was conducted during late autumn 2008.

## 6.1 Mode of procedure

The IASB received a total of 161 comment letters to the *Exposure Draft of an IFRS for SMEs*<sup>30</sup>. A glance through a number of the comment letters, however, showed that the large total number of pages of the comment letters would make a reading through of all documents too time consuming in relation to the scope of this study. Furthermore, thirteen of the comment letters were written in Spanish or German and, because of my limited knowledge of these languages, these comment letters were excluded from further analysis. By means of the search function of Adobe Reader, which makes it possible to search through a large number of PDF files simultaneously, the remaining 148 comment letters were searched for the search words displayed in table 6.1 below. The search words represent both general concepts related to entrepreneurship such as *entrepreneur*, *innovation* and *growth*, and the types of accounting information that in the literature study (section 2.4), the expert interviews (chapter 3) and the document study of the draft of K2 (chapter 4) have been identified as significant in an entrepreneurial context.

The term *user/s* is not included as a separate search word in table 6.1 since it received an enormous amount of occurrences (1 177 occurrences in 100 CLs). The time-consuming task of going through all comments related to *user/s* were not considered to be worthwhile, since respondents to the draft *IFRS for SMEs* were not requested to comment on users in the context of entrepreneurial SMEs in specific. However, in cases where users are discussed in relation to comments on other search words of table 6.1, such discussions are presented in the results section 6.2 below.

With reference to the exclusion of the search word *user/s*, the terms *venture capital* and *risk capital* (search words 7 and 8) make up an exception, since previous research has shown that entrepreneurial SMEs generally are financed by risk capital to a larger extent than what is the case in SMEs in general (see section 2.3.1). The search *venture capital* (search word 8) initially received 8 hits in 5 comment letters, but since one of the comment letters mentions *venture capital* as a form of *risk capital* (and is therefore included among the hits on *risk capital*, search word 7), these numbers were reduced to 7 and 4 respectively.

---

<sup>30</sup> A list of the respondents to the draft *IFRS for SMEs* is presented in Appendix 4.

Table 6.1 Occurrences of search words in the comment letters to the draft IFRS for SMEs

	Search word	Number of CL's with matches	Occurrences of search word
1	entrepreneur(ship/ial)	6	17
2	innovat(ion/ive)	3	4
3	business opportunit(y/ies)	0	0
4	growth	6	6
5	gazelle	0	0
6	IPO	0	0
7	risk capital	2	2
8	venture capital	4	7
9	develop(ment)	91	570
10	cash flow statement	37	72
11	intangible	59	320
12	research and development	21	37
13	contribution margin	0	0

The number of comments letters that provides with matches on a specific search word is illustrated in table 6.1 together with the number of occurrences of the search word. Comment letters with matches on one or more search words have been further examined in search for comments of relevancy to this study. This examination has resulted in the division of comment letters into three categories where the first category includes comments where information needs and consequences of different accounting solutions are discussed in relation to concepts of entrepreneurship and growth, covering the search words 1 - 8 in table 6.1. The search word *develop(ment)* (search word number 9) received a considerable number of matches but was excluded from further analysis since a glance through a number of sections with occurrences on the term showed that many of the hits on this search word bear upon insertions on the development of the accounting regulation in general rather than discussions on entrepreneurial development of a business or a business idea. The term, however, remains in the study as a component of the search term *research and development* (search word 12).

The second category includes comments on cash flow (search word 10). The initial search for the term *cash flow* provided with a total of 157 matches in 58 documents. A glance through the matches found that the concept appeared very often in comments on the calculation of fair value of assets (revaluations) which comprises the prediction of the future cash flow directly traceable to a specific asset – a signification of the term that is not of immediate focus to this study. This problem was, however, solved by changing the search word to *cash*

*flow statements* – a procedure that reduced the number of occurrences to 72 in a total of 37 documents.

The third and final category includes comments on intangible assets (search word 11-12). The search for the term *research and development* was initially supplemented by a search for *R&D*, which provided with eight hits in a total of four documents. Since this search did not provide with any matches in excess of the matches already identified by the search for *research and development*, the search word R&D was excluded from table 6.1.

The search word *contribution margin* (13) did not receive any matches and is consequently excluded from any further analysis.

The comment letters belonging to the same categories have been analyzed in search for similarities and differences in order to identify any major themes of discussions. In section 6.2 below the results of this analysis is presented for each of the three categories in turn.

## 6.2 Results of the document study

### 6.2.1 Comments on entrepreneurship, innovation and growth

The term *entrepreneurship* (search word 1 of table 6.1) occurs in six of the comment letters, and in all but one of the documents it is used as a synonym of smaller entities in general. In the comment letter authored by the accounting organization Certified General Accountants of Canada (CL 46) - the single exception - it is pointed out that entrepreneurial SMEs with *growth* aspirations would benefit from preparing their financial statements according to the *IFRS for SMEs* since it would facilitate the transition to full IFRS as the entity transforms and evolves.

When the search word *innovat(e/ion/ive)* (search word 2 of table 6.1) appears in the comment letters it generally refers to innovative accounting solutions rather than the innovative activities carried out by entrepreneurial businesses. A German trade association (CL 105) makes up the only exception when stating that the ability to innovate, together with decisiveness and flexibility, makes up the success factors for many small and medium-sized entities. In addition, to secure their *growth* and competitiveness, small and medium-sized entities are looking for new markets and low cost production facilities across borders which make the need of developing a single set of international standards for SMEs critical.

Two to the comment letters that contain the term *growth* (search word 4) have already been mentioned above in relation to *entrepreneurship* and *innovate(e/ion/ive)*. In addition, the authors of CL 134 are concerned that a specification in quantitative terms of entities for application of the standard, such as number of employees and turnover (which has been discussed by the IASB), may cause entities to restrict growth to avoid having to comply with the *IFRS for SMEs*. It is suggested that “if businesses arrange their affairs to avoid compliance with what they consider to be onerous burdens this action may hinder best practice for economic development” (CL 134, p. 7). What specific area, or areas, of the suggested standard that is considered to lead to such behavior of reporting entities is not discussed in the comment letter, however.<sup>31</sup> In the remaining three comment letters with hits on the search word *growth*, the concept is mentioned in relation to growth of different items of the financial reports in general, with no clear connection to the entrepreneurial context in specific.

In all of the six comment letters with hits on the search words *risk capital* and *venture capital* (search words 7 and 8 of table 6.1), the terms are mentioned with reference to user groups of SMEs financial reports. In five of the comment letters, venture/risk capitalists are considered to belong to the user groups of SMEs financial reports, and in one of these comment letters the wording “significant user” is used with reference to venture capitalists (CL144). In one comment letter (CL 11), venture capitalists were mentioned with reference to stakeholders whose information needs were *not* considered to be substantial enough to legitimize the development of an accounting standard with the purpose of increasing the comparability across borders.

## 6.2.2 Comments on cash flow statements

In developing the draft *IFRS for SMEs*, the IASB considered some recognition and measurement simplifications not incorporated in the final draft. Some of the potential simplifications were identified in existing national accounting standards for SMEs and some were proposed by the Board’s constituents. One such simplification that the IASB considered was to eliminate the requirement to prepare a cash flow statement. However, since a cash flow statement according to the Board is not very difficult to prepare and since the great majority of lenders and other users of SMEs financial statements who had communicated with the Board had indicated that the cash flow statement is useful to them, a requirement to prepare a cash flow statement was included in the draft *IFRS for SMEs* (IASB, 2007b). Consequently, the reporting entities are according to the draft required to “present a cash flow statement that reports

---

<sup>31</sup> With respect to the restrictive criteria for recognition of development costs as assets, see section 6.2.3 below.

cash flows for a period classified by operating activities, investing activities and financing activities” (IASB, 2007a). The respondents were specifically requested to comment on whether they consider that the IASB made the correct decision when deciding not to eliminate the requirement to prepare a cash flow statement.

The search for the term *cash flow statement* (search word 10 of table 6.1) resulted in matches in 37 comment letters, of which 21 documents include comments on the issue of whether the cash flow statement should be mandatory for SMEs. The authors of 14 of the 21 comment letters give support to the suggestion to make the cash flow statement mandatory for SMEs, while the authors of 7 comment letters express the opinion that there should be no such requirement.

### 6.2.2.1 Support for mandatory cash flow statements

The 14 comment letters that express a positive attitude towards the cash flow statement requirement are displayed in table 6.2 below.

**Table 6.2 – Comment letters providing support for a mandatory cash flow statement**

Argument Respondent	CL	Significant to capital providers	Significant to management	Significant to users in general	Cash management	Easy to prepare	No specific argument provided
South African professional accountant	4						X
CPA Australia	11						X
CGA Canada	46						X
ICPAK	48	X	X	X		X	
CPA Ireland	54	X					
IDW Germany	62						X
FIDEF	67						X
Chartered accountant of Pakistan	98				X	X	
Deloitte	114			X			
Prof. acc. Argentina	131						X
CPA Hong Kong	140						X
IFAC	142	X					
South African prof. acc.	155		X				
EFRAG	161				X		

#### Document study of comment letters to the IASB draft IFRS for SMEs

The most frequent argument for making the cash flow statement mandatory is, as illustrated by the four first columns (“Significant to capital providers”, “Significant to managers” etc.) of table 6.2, that it provides with significant information to users of SME’s financial reports, among which capital providers receive the most attention. In the comment letter by Deloitte, UK (CL 114), to start with, the cash flow statement is referred to as a key financial statement that users of SMEs financial statements place significant reliance on, and that there should be no significant divergence between the cash flow statement of the *IFRS for SMEs* and *IAS 7 Cash Flow Statements*. In yet another comment letter authored by representatives of the CPA Ireland (CL 54), banks are put forward as a major source of external funding for many SMEs and, since bankers in general attach importance to information on cash flow, that the financial reports of SMEs should incorporate a statement of cash flow. In the comment letter by IFAC (International Federation of Accountants, CL 142) a similar line of argument for making cash flow statements mandatory for SMEs is followed when referring to previous research carried out by the authors where the results show that creditors in their role as the main capital providers of SMEs demand such statements.

In two of the comment letters of table 6.2, management is included among the users who benefit from information on cash flow (CL 48, 155), implicating that financial reporting information is considered not only to be important to external users but to managers of SMEs in their internal management of their businesses. Furthermore, in yet two comment letters the significance of cash management is provided as an argument for making the cash flow statement mandatory for SMEs. In CL 98 authored by a chartered accountant of Pakistan it is emphasized that cash management is significant in the SME context and that managing cash as a fundamental financial resource is critical to the survival of a business. In the comment letter authored by EFRAG (CL 161) the general argument is that the cash flow statement helps understand how and why the cash position of the entity has varied over time, in terms of investments, changes in financing structure and the impact of relationships with owners etc.

In two of the comment letters, it is argued that the cash flow statement is easy to prepare and that it therefore is not reasonable to remove the requirement for reasons of simplification (CL 48, 98). Altaf Noor Ali, a chartered accountant of Pakistan, also finds it “puzzling why SME could find it difficult to produce, given the level of technology” (CL 98).

#### 6.2.2.2 Criticism against mandatory cash flow statements

The seven comment letters claiming that the cash flow statement should *not* be mandatory for SMEs are displayed in table 6.3 below. Most of the respondents do not provide with any argument for their critical view on this issue. All three

respondents who provide an argument for their position are however skeptical towards the usefulness of a cash flow statement to the users of SMEs financial reports.

**Table 6.3** Comment letters providing the view that the cash flow statement should not be mandatory for SMEs

<b>Respondent</b> \ <b>Argument</b>	<b>CL</b>	<b>Burdensome to prepare</b>	<b>Not significant to users</b>	<b>No specific argument provided</b>
Kingston Smith LLP	8			x
ZDH Germany	27			x
CIMA	41	x	x	
AAT	100		x	
SCAA China	102			x
ASB India	126		x	
DGRV Germany	132			x

The most explicit criticism towards making the cash flow statement mandatory is offered by representatives of CIMA, who cannot see how the benefit of a cash flow statement to users outweighs the burden on preparers in small companies (CL 41). The AAT (CL 100) is somewhat gentler when stating that the cash flow statement is not in general essential to users of SMEs' financial statements, and that it therefore should not be an obligation for SMEs reporting under *IFRS for SMEs*.

Furthermore, ASB India argues that the benefits of cash flow statements are limited in case of SMEs, and that other financial statements provide sufficient information on financial health and liquidity position (CL 126):

*“A few users may find CFS useful but not all. Perhaps the only interest group interested in CFS would be lenders, who can demand CFS when required. Thus, CFS is more a special purpose financial statement for SMEs rather than a general purpose financial statement”. (CL 126)*

### 6.2.2.3 Other comments concerning cash flow statements

Besides the issue of whether the cash flow statement should be mandatory or not, most comments concerning cash flow are focused on the different items of the cash flow statement. The issue that has received most attention in this respect is whether the direct or indirect method is preferable when calculating

cash flow from operations. Among the 17 respondents who take a stand on this issue 14 advocate the indirect method (frequent arguments: easy to prepare, the ultimate choice by larger and/or publicly traded companies) while 3 prefer the direct method. In addition, 4 respondents are of the opinion that the reporting entities should be able to choose between the methods.

### 6.2.3 Comments research and development (R&D) and other intangible assets

With reference to internally generated intangible assets, “IAS 38 Intangible assets” requires all research costs to be charged as expenses when incurred, while development costs that are incurred after a project is deemed commercially viable are to be capitalized. The draft *IFRS for SMEs* proposes an option not available under IAS 38 for reporting entities to choose to treat all development costs as expenses even if the development project meets the criteria for capitalization as an intangible assets. This also means that if the criteria for capitalization are met the reporting entity can choose to capitalize the development cost as an asset. Consequently, the restriction concerning internally generated intangible assets that is incorporated into the K2 drafts by the Swedish *BFN* is without parallel in the draft *IFRS for SMEs*.

The search word *research and development* (12) received matches in 21 comment letters of which 14 address the issue of whether the *IFRS for SMEs* should include an option to expense all research and development costs when incurred. 13 of the 14 respondents provide support for the expense option, while only one respondent take part against such an option. Most of the respondents who are positive towards the expense option do not provide with any argument for their standpoint, two respondents put forward reasons of simplification and one respondent believes that such a solution would reduce the divergence between the *IFRS for SMEs* and the national legislation.

Of the 13 respondents providing a view on the issue of whether the expense option should be included in the *IFRS for SMEs* it is only the INAA Group (The International Network of Accountants and Auditors, CL 124) that expresses criticism against such an option. It is emphasized in the comment letter that many SMEs engage in research and development - particularly in the IT sector – and if all their research and development costs were treated as expenses the overall picture provided by their financial statements would be significantly influenced and, consequently, not reflective of the economic lifecycle in the industry.

According to the expense option provided by the draft *IFRS for SMEs* it is permitted for the reporting entity to choose to capitalize development costs as

soon as the criteria for recognition are met. Among the comment letters with matches on the search word *research and development* one single document have been identified discussing the consequences of the restrictive criteria for recognition of development costs as assets. In the comment letter authored by representatives of (CL 134), it is emphasized that even if it may not be preferable economically to contract out R&D, the reporting entities might choose such a strategy if this means that they can capitalize the cost of a purchased 'secret recipe' or brand name as an asset in the balance sheet.

Besides commenting on whether the option to expense development costs is appropriate or not, respondents have focuses on the measurement of intangible assets in general to a great extent. A survey of the 59 comments letters with hits on the term *intangible* (search word 11) shows that respondents have mainly focused their discussions concerning intangible assets on three issues. Firstly, the opinion is widely spread among respondents that the separation of assets with indefinite lives from the ones with definite lives is too complicated for SMEs, and that the *IFRS for SMEs* should incorporate an option to amortize on all intangible assets. Secondly, the requirement to calculate fair value has received a lot of criticism since the necessary calculations are considered as too hard and burdensome for SMEs (the cost model is the preferred alternative among respondents). Thirdly, extensive criticism has been directed towards the suggested requirement to test assets on an individual exclusively, and never as a part of a group of assets.

#### 6.2.4 Summary of results

Among the items of financial reporting information that have been sorted out in the literature study (chapter 3), the expert interviews (chapter 4) and the document study of the K2 drafts (chapter 5), only cash flow and intangible(s)/research and development received occurrences in the comment letters to the draft *IFRS for SMEs*. With reference to cash flow, only 21 of the total of 148 comment letters includes an opinion on whether the SMEs should be required to publish cash flow statements. The majority of the respondents providing their opinion on the issue believes that there should be such a requirement, and the most frequent argument is that cash flow statements provide with information that is significant to users. Besides the issue of whether the cash flow statement should be mandatory or not, most comments on cash flow focus on different items of the cash flow statement and issues such as whether the direct or indirect method is preferable when calculating cash flow from operations. In this respect, the indirect method is in great majority.

Concerning the item of research and development, the majority of the respondents support the suggested option to expense all research and

*Document study of comment letters to the IASB draft IFRS for SMEs*

development costs rather than requiring capitalization whenever the recognition criteria are met. Few respondents provide with an argument for their standpoint on this issue. The comments with hits on the term intangible(s) turned out to be mostly concerned with different aspects of measurement of intangible assets.



## 7 Comparative analysis

With the frame of reference as the point of departure (chapter 2), this chapter presents a comparative analysis of the results of the different steps of data collection carried out in this study (chapter 3, 4, 5 and 6), bringing forward and discussing similarities and differences between the results of the different steps. Section 7.1 firstly attends to the users and purposes of entrepreneurial SMEs' financial reports, and, then, section 7.2 deals with the significant areas of financial reporting information.

### 7.1 Users and purposes in the context of entrepreneurial SMEs

The project descriptions published on the IASB website, clearly induce that the IASB SME-group on an early phase in the work with developing the *IFRS for SMEs* established that the main users of SMEs financial reports are the same as those identified in the IASB Framework, but with extra weight given to providers of capital and debt (IASB, 2003). Furthermore, the working hypothesis of the IASB SME-group has been that management does not belong to the main users of regulated reports (see section 1.1). With reference to the Swedish context, *Bokföringsnämnden* (BFN, 2006) makes clear that they regard creditors and the tax authority as the most important users of K2 entities' financial reports, while the information need of other users such as owners and employees are considered to be met by other means.

The picture provided by both international and Swedish standard setters that management does not belong to the main user groups in the SME context is not consistent with the academic literature where a number of studies can be found suggesting that management actually makes up a significant user of SMEs financial reports (section 2.2). When turning to the entrepreneurial context – which is in focus in this study - none of the previous empirical studies analyzed in the literature study (chapter 3) explicitly investigate the main user groups of entrepreneurial entities' financial reports. Even so, the entrepreneurs in Blomkvist's (2008) qualitative pilot study emphasize the wish to secure that the information needs of users are met as an incentive for their participation in the year-end procedures of constructing financial reports. In this respect, shareholders, other financiers (including a risk capitalist) and customers are put forward as important users. The studied entrepreneurs also emphasize the significance of keeping themselves up to date with the financial aspects of their businesses, implicating that the entrepreneurs actually consider themselves as important users of their entities financial reports.

All accounting experts interviewed for this study (chapter 4) consider the communication with external capital providers to be the principal purpose of entrepreneurial SMEs' financial reports, and the most frequent user group in this respect is considered to be bankers. In line with Berggren, Lindström & Olofsson (2001) and Storey (1994), all accounting experts also believe that the continuous high demand for financial capital makes the extent to which risk capitalists and other external owners belong to the owner structure greater in entrepreneurial SMEs than what is the case in SMEs in general. In the communication with external financiers the financial reports are by all respondents considered to be important, and by two of the respondents the wording "extremely important" is used with respect to the role of financial reports in the process of acquiring financial capital to secure continuous growth. It is also suggested that managers of entrepreneurial SMEs in general are aware of the significance of keeping their financial reports on a high quality standard, or, at least, wise enough to turn to professional advisors to tend to these issues. Other important users of entrepreneurial SMEs financial reports put forward by the interviewed accounting experts are customers, suppliers, employees and potential acquirers.

Regarding the usefulness of financial reporting information to managers of entrepreneurial SMEs in their internal decision-making, the interviewed accounting experts have provided with varying responses. Even though several of the respondents consider the connection to be close between management accounting information and financial reporting information, the majority – five out of seven - consider the financial reports to be of limited use to managers in their internal decision-making. Two of the respondents are of the opposite opinion, bringing forward the importance of financial reports particularly in confirming the management accounts. In line with the suggestions in the literature, (e.g. Samuelson, 1990), one of the respondents also suggests that financial reporting information is used for internal purposes to a higher extent in the smaller entities of the SME group than what is the case in the larger ones. This could be a possible explanation for the importance denoted to financial reporting information in internal management by the entrepreneurs of Blomkvist's qualitative pilot study, who are all representing smaller entities within the SME group (see section 3.2).

The respondents to the two K2 drafts were not requested to comment on the issues of users and decision-making purposes in specific, and neither were the respondents to the draft *IFRS for SMEs*. Consequently, the document studies of the comment letters to these drafts (chapter 5 and 6) do not make up a sufficient source of information in terms of the respondents' opinions on main user groups and purposes in the SMEs context in general and especially not in the context of entrepreneurial SMEs. Even so, in the comment letters to the K2 drafts that include discussions on the suggested prohibition to capitalize

### Comparative analysis

internally generated intangible investments, several references can be found to the users of financial reports, among which capital providers stand out. Several of the respondents draw attention to the high extent to which growth-oriented SMEs in general rely on intangible resources, and argue that the suggested prohibition to capitalize intangible resources would restrict the possibilities for these entities to raise capital from external resources, which is considered a prerequisite for their survival and development. In one of the comment letters, it is also suggested that the financial reports of innovative and entrepreneurial businesses are not only used by management to inform external users but for the purposes of internal decision-making by management as well. The authors of that same comment letter also express their concern that the proposed regulation about internally generated intangibles will lead to the provision of less relevant information to the entrepreneurs managing innovative businesses.

## 7.2 Financial reporting information of specific importance in an entrepreneurial context

In table 7.1 below the results of the different steps of the study are summarized in terms of the areas of financial reporting information that have been sorted out as likely to be of significance to managers of entrepreneurial SMEs in their provision of information to users. As illustrated in the table, information on cash flow and intangibles stand out as significant from the results of the literature study as well as the expert interviews and, concerning intangibles, the document study of the K2 comment letters. In the column for the document study of the comment letters to the draft *IFRS for SMEs*, the item of cash flow is entered within brackets to demarcate that matches on this concept were found in many comment letters rather than being specifically connected to an entrepreneurial context by the respondents.

Table 7.1 Financial reporting information of specific importance in an entrepreneurial context

Financial reporting information	Literature study of previous empirical studies	Interviews Accounting experts	Document study K2	Document study IFRS for SMEs
Cash flow	X	X		(X)
Intangibles	X	X	X	X
Sales	X			
Contribution margin	X			
Growth ratios		X		
Other disclosure		X		

In section 7.2.1 and 7.2.2 below the items of cash flow and intangibles are discussed in turn, bringing forward and discussing similarities and differences between the results of the literature study, the expert interviews and the document studies. Then, in section 7.2.3, information on growth ratios and other disclosure that has received specific attention from the interviewed accounting experts is discussed. The usefulness in the context of entrepreneurial SMEs of each of the items is summarized with reference to the qualitative criteria of relevance, reliability, comparability and understandability (see section 2.1.1 above for a presentation of the criteria).

### 7.2.1 Information on cash flow

The literature study of previous empirical studies of accounting in entrepreneurial contexts (chapter 3) provided with indications that information on cash flow is of specific importance in the context of entrepreneurial SMEs. This is in line with the study by Sexton et al (1997) showing that entrepreneurs rank how to use cash flow in order to make operational and financial decisions as their most desired learning need. The significance denoted to cash flow in previous research was also confirmed by the results of the interviews with accounting experts (chapter 4). All of the interviewed accounting experts consider information on cash flow to be crucial in the context of entrepreneurial SMEs; several of the respondents do not only believe that cash flow is *the* most important item of information that should be, and often is, included in the financial reports of entrepreneurial entities, but that the cash flow statement actually should be mandatory for all companies irrespective of

### Comparative analysis

size<sup>32</sup>. Among the arguments for the usefulness of cash flow information put forward by the accounting experts is the continuous demand for financial capital in entrepreneurial entities, and the extent to which capital providers make use of cash flow statements in their credit analyses. Also, the suggestion in the literature that entrepreneurial entities in general rely on intangible investments to a great extent is confirmed by the interviewed accounting experts; and, as suggested by several of the respondents, in situations when the intangible values are not sufficiently reflected in the balance sheet of the entrepreneurial entity, the cash flow statement provides with important information needed in estimating the prospects of the business.

The attention given to cash flow information by the interviewed accounting experts is without parallel in the comment letters to the two K2 drafts (chapter 5). In line with the previous national accounting regulation for SMEs, the two K2 drafts do not include any requirement for cash flow statements, and respondents were neither requested to comment on this exemption. In all that, the absence of comments on cash flow statements does not automatically imply that the respondents to the K2 drafts would reply in the negative if asked of the relevance of cash flow information in the SME context in general or in the context of entrepreneurial SMEs in specific.

In contrast to the K2 drafts, the draft *IFRS for SMEs* (chapter 6) includes a requirement for reporting entities to publish cash flow statements and in the introduction to the draft respondents are asked explicitly to provide their opinion on the suggested requirement. Only 21 (14 %) of the 148 comment letters includes the respondents' opinions on this issue and among these the majority – 14 comment letters - provides support for the requirement. In only half of the supportive comment letters an argument for the opinion put forward is provided, and the dominating argument in these comment letters is the importance of cash flow information to users, including capital providers and management. Whether the absence of comments on this issue from so many respondents indicates that the suggestion to make cash flow statements mandatory for SMEs is supported, or if there are other reasons, has not been possible to find out by reading the comment letters alone. Still, even if there are just a few responses to the suggested requirement of cash flow statements, the circumstance that the majority of the respondents commenting on this issue answer in affirmative does at least not provide with evidence against the usefulness of the cash flow statement to SMEs in general, or to entrepreneurial SMEs in specific.

---

<sup>32</sup> According to the present Swedish accounting regulation privately-held enterprises with less than 200 employees are not required to prepare cash flow statements.

Taken together the results of the different steps of this study, cash flow information is very likely to be of high *relevance* to managers of entrepreneurial SMEs in their provision of information to users. Also, the straightforward way in which in- and outflows of cash is measured provides with arguments for a high *reliability* of cash flow information. Furthermore, the indications of previous empirical studies (e.g. Lundell, 2005; Collier, 2005), together with the suggestions by several of the interviewed accounting experts as well as respondents to the draft *IFRS for SMEs*, that cash flow information is uncomplicated for users to understand provide support for the fulfillment of the *understandability* criterion. From the perspective of *comparability*, however, it could be argued that financial reporting information prepared in accordance with the accrual method – where revenues for delivered goods and services are compared to expenses for consumed resources - is preferable to the reporting of in- and outflows of cash. In all that, as long as it is not a matter of compensating the calculation of the periodical income with cash flow, but rather to let the two approaches complement each other, the fulfillment of the comparability criterion would not make up a serious problem with respect to the usefulness of the information contained in the financial reports as a whole.

### **7.2.2 Information on intangible assets**

In the pilot study by Blomkvist (2008), four of the five interviewed entrepreneurs state that the transactions that receive the most of their attention in the construction of financial reports are investments in intangible assets. The respondents' attention are in this respect centered on whether the investments should be capitalized as assets or not, and the consequences of the different alternatives. In accordance with Blomkvist all accounting experts interviewed for the study presented in this thesis consider information on intangible investments to be of particular importance in an entrepreneurial context. Besides the legal aspect of writing off expenses for intangible investments to profit, which is considered critical to the very survival of entrepreneurial entities, there is some hesitance among the respondents concerning the specific consequences of not having investments in intangible resources capitalized as assets in the balance sheet. Concerning the informational aspect, however, the predominant view among the respondents is that disclosed information on intangible investments, in narrative form and/or in numbers, makes up a fully conceivable alternative to capitalization.

In the document study of the comment letters to the K2 drafts, all comments that were sorted out as relevant to this study are aimed at the suggested prohibition to capitalize investments in intangible resources as assets. In fourteen of the sixteen documents that include a discussion on the suggested regulation the suggested prohibition is criticized, and one frequent argument against the prohibition is the risk that too many development intensive

### Comparative analysis

companies will be compelled to set up a balance sheet for liquidation purposes with the subsequent risk of bankruptcy. This will in turn lead to that the reporting entities will take measures in order to avoid writing off expenses for intangible investments, with increased administrative costs as a consequence. An example of such strategies is the compliance with a more complex regulation (K3) or the restructuring of development projects. Several of the respondents to the K2 drafts also believe that the suggested treatment of internally generated intangible assets will lead to the provision of less relevant information to users of SMEs financial reports, and the restraining effect upon the development of new innovations. Such an effect is not only considered to bring about severe consequences for the individual companies following the K2 regulation but for the development of the economy on the societal level as well.

While the two K2 drafts prohibit capitalization of investments in internally generated resources, the draft *IFRS for SMEs* is less restrictive in that it includes an option for reporting entities to choose either to capitalize or to expense such investments as costs when incurred. There are relatively few comments on this option – only 9,5 % of the total of 148 comment letters includes a comment on this issue – but the majority of the respondents (13/14) commenting on this issue provides support for the capitalization/expense option. In all that, in the published final version of the *IFRS for SMEs* of July 2009 the IASB has taken away the possibility to capitalize development costs even if the recognition and measurement criteria of 'IAS 38 Intangible assets' are met (IASB, 2009). In other words, by the prohibition to capitalize not only expenses for research but development costs as well, the *IFRS for SMEs* is in its final version even more restrictive than the IAS 38. With this fact by hand, one might certainly wonder whether the responses to the draft *IFRS for SMEs* would have been different if respondents would have known about the decision the IASB was about to make in this respect?

To sum up, the indication provided by the results of the literature study that information on intangible investments is of high *relevance* in an entrepreneurial context is confirmed by the interviewed accounting experts, as well as the respondents to the two drafts of K2. Since innovation is a central part of the entrepreneurial process (e.g Acs & Audretsch, 2003; Wickham, 2004), and given that it is widely accepted today that intangible resources are pivotal for modern companies in their efforts to stay innovative and competitive, the development of sound financial reporting standard with respect to intangible assets appears crucial. From the perspective of standard setters, however, there has been a great concern for the difficulties involved in making *reliable* measurements of the cost of such assets – not at least concerning internally generated assets – leading to the development of a restrictive regulation concerning such assets. It is very likely, however, that the differences in restrictions depending on whether intangibles have been internally generated or acquired will have

negative effects upon the *comparability* of financial reports, both through time and between entities. Also, in terms of *understandability*, there will be rather extensive demands imposed on users to get familiar with the regulation in order to make sense of financial reports that partly represents the intangible investments of the firm, and partly not. As suggested by the interviewed accounting experts, one possible course of action to avoid the difficulties of making reliable measurements, as well as increasing the comparability and making the reports easier to understand by users, would be to describe the intangible investments in narrative form instead of capitalization (or as a supplement).

### 7.2.3 Financial ratios and other additional disclosure

In the literature study of previous empirical studies about accounting in entrepreneurial contexts, information on sales/revenue (chapter 3) was sorted out as significant to the studied entrepreneurs for purposes of internal decision-making. Turning to the accounting experts interviewed for this study (chapter 4) the respondents attend more to sales/revenues in terms of cash inflows than to the accrual based sales/revenue item of the income statement. The importance of disclosing additional information on the contracts behind the revenue number of the income statement is, however, stressed by two of the respondents, and one of the respondents also argue for the importance of disclosing information on the methods applied when measuring the revenues. Furthermore, several of the respondents mention information on sales/revenue information as input to the calculation of financial ratios in general.

The majority of the interviewed accounting experts stress the importance of information on financial ratios in the entrepreneurial context, and all respondents consider financial ratios measuring various aspects of growth to be pivotal to include in the financial reports of entrepreneurial SMEs. When the point of departure is that growth is the very essence of entrepreneurship – which is the case in this study - a measurement of growth becomes by definition *relevant* in an entrepreneurial context. As suggested by one of the respondents, however, a prerequisite for the relevance of financial ratios is that users have access to information on how the ratios have been calculated. When the components of growth ratios are sufficiently described they provide with information that is *comparable*, both through time and between enterprises. Also, by supplementing the information on growth ratios with descriptions on how the ratios have been calculated the information on growth ratios would also be readily *understandable* to users. With respect to *reliability*, however, it is evident that the extent to which information on financial ratios is reliable will always be dependent on the reliability of their components.

### Comparative analysis

Several of the interviewed accounting experts consider additional disclosed information to be of high relevance to users of entrepreneurial SMEs financial reports. One important reason for this is the high extent to which entrepreneurial SMEs in general are considered to rely on intangible values such as research and development. The financial reports of entrepreneurial entities are not only considered to insufficiently reflect the earning capacity of individual research and development projects, but also to pay too little attention to expectations in terms of the future collective earning capacity of ongoing projects. Besides disclosure of additional information on individual intangible projects, several respondents therefore also argue for the importance of disclosing more general narrative information related to the business concept of the reporting entity. In this respect, information on products, services and markets, as well as information on the collected research and development projects in progress - together with estimations on the future earning capacity of such projects - has been put forward as significant to the users of entrepreneurial SMEs' financial reports.

Even though narrative information on business concepts and development projects is likely to be of high relevance to the users of entrepreneurial SMEs financial reports, such information could be questioned in terms of reliability, not at least concerning the future-oriented aspects of the information. In addition, narrative descriptions can never be as comparable as numerical figures. By providing significant supplementary information in the suggested areas, however, the additional disclosure could have the capacity to improve the *reliability* and *comparability* of the numbers provided in the income statement and the balance sheet, and also, to make the numbers more *understandable* to users.



## 8 Conclusions and further research

The main purpose of this study has been to sort out areas of financial reporting information that are likely to be of significance to managers of entrepreneurial SMEs in their provision of information to users. In order to fulfill this purpose data has been collected in several sequential steps, including a literature study of previous empirical studies about accounting in entrepreneurial contexts, interviews with accounting experts, and document studies of comment letters to *Bokföringsnämnden's* (BFN) two drafts of the accounting standard *Financial reporting in small companies (K2)*, and IASB's *Exposure draft of an IFRS for SMEs*.

This chapter firstly presents the study's overall conclusions with respect to the users and purposes of entrepreneurial SMEs financial reports and, secondly, regarding the areas of financial reporting information that have been sorted out as likely to be of significance to managers of entrepreneurial SMEs in their provision of information to users. Then, some suggestions of further research on financial reporting in the context of entrepreneurial SMEs are presented.

### 8.1 Conclusions of the study

#### 8.1.1 Users and purposes in the context of entrepreneurial SMEs

According to the study results the continuous high demand for financial capital is a great challenge to managers of entrepreneurial SMEs in their efforts to make their entities develop and grow. In this context, financial reports make up an important tool mainly for informing external capital providers, among which bankers hold a prominent position. The high demand for financial capital also makes risk capitalists and other external owners more important as financiers of entrepreneurial SMEs than what is the case in SMEs in general. Other important users of entrepreneurial SMEs financial reports are customers, suppliers, employees and potential acquirers.

Concerning the significance of financial reporting information to SME managers in their internal decision-making, there is a discrepancy between the results of previous empirical studies and the picture provided by standard setters. While previous studies suggest that management belongs to the main user groups of SMEs' financial reports, standard setters generally exclude management from the target audience of their standards. The collected results of the different steps of this study - where the focus has been on the

entrepreneurial entities within the SME-group – suggest that managers make use of financial reporting information not only in informing external users but in the internal management of their businesses as well. Concerning the extent of this use, however, the results of the different steps of the study diverge.

### **8.1.2 Significant areas of financial reporting information in an entrepreneurial context**

The areas of financial reporting information sorted out in this study as likely to be of significance to managers of entrepreneurial SMEs in their provision of information to users are above all cash flow and intangible assets. Firstly, information on *cash flow* is likely to be of significance in the entrepreneurial context not at least since the development of entrepreneurial activities puts a lot of pressure on managers to secure the continuous inflow of cash. The extent to which capital providers make use of cash flow information provides with further argument for its importance in the entrepreneurial context. Also, entrepreneurial entities tend to rely on intangible assets to a high extent, and these assets are in general not sufficiently reflected in the balance sheets. Cash flow provides in this respect straightforward and reliable complementary information that is important when assessing the prospects of the business. Considering that privately-held SMEs according to the present Swedish accounting regulation are not required to prepare cash flow statements, the results of this study makes a further inquiry into the importance of cash flow information to the users of entrepreneurial SMEs relevant.

Secondly, information on *intangible assets* is according to the results of this study likely to be significant in an entrepreneurial context. The possibility to capitalize expenses for intangible investments is crucial not at least to avoid the legal consequences of bankruptcy law, which may be critical to the very survival of development intensive entrepreneurial SMEs. The importance of innovation as a central part of the entrepreneurial process also makes financial reporting information on intangibles highly relevant from an informational perspective. Even so, there has been a great concern among standard setters regarding the possibility to measure reliably the costs of intangible assets. In cases when the accounting regulation restricts the possibility to capitalize such assets, a conceivable alternative to capitalization is according to the accounting experts interviewed in this study to disclose information on the investments in narrative form and/or in numbers. Such a strategy would reduce the problems of comparability that arise due to the different treatment offered by the current regulation concerning internally generated intangibles, on the one hand, and acquired intangibles on the other. Furthermore, by describing investments in intangible resources in text, rather than capitalizing - or as a complement to

### *Conclusions and further research*

capitalizing - may also lead to financial reports that are more readily understandable to users.

While entrepreneurial entities of today are highly dependent on intangible investments, it is not unlikely that such resources will be even more important in the future. Considering the restrictive attitude among standard setters towards recognizing intangible investment as assets, further research on the consequences of different ways to report on intangibles – by capitalizing as assets and/or in the form of (narrative) disclosure - appears as significant.

In addition to cash flow and intangible assets, financial ratios in general, and financial ratios measuring various aspects of growth in specific, i.e. *growth ratios*, has been sorted out as likely to be of specific importance to include in the financial reports of entrepreneurial SMEs. Besides additional information on individual intangible assets, *additional disclosure* of information related to the collective earning capacity of ongoing projects - including the business concept of the reporting entity - has also been identified as significant in the entrepreneurial context.<sup>33</sup>

## **8.2 Suggestions of further research on financial reporting in the context of entrepreneurial SMEs**

In this study, information on cash flow, intangible assets and growth ratios has been sorted out as likely to be significant to managers of entrepreneurial SMEs in their provision of financial reporting information to users. The results of this study makes up an important contribution to a future research project where the importance of the financial reporting information sorted out in this study could be further investigated in an empirical setting. One possible course of action for such a future research project could be to conduct case studies of the financial reporting practices of entrepreneurial SMEs that already include information on intangibles – capitalized or described in narrative form – cash flow and growth ratios in their financial reports. In such a project the usefulness of the financial reporting information in these areas could be investigated from the perspective of the managers of the entrepreneurial case companies, as well as from the perspective of the external users of the financial reports published by the case companies.

---

<sup>33</sup> The study results regarding financial ratios and additional disclosure are based on the interviews with accounting experts.

Another possible future research project could have the aim of investigating the consequences of different accounting rules in the areas of financial reporting information sorted out in this study. Respondents for such a research project could preferably be managers of entrepreneurial SMEs together with the external users of their entities' financial reports. For each of the areas of financial reporting information sorted out in this study as likely to be of specific importance in the context of entrepreneurial SMEs - cash flow, intangibles and growth ratios - a tentative/experimental accounting rule could be formulated. In the process of creating the tentative accounting rules the results of the study presented in this thesis would provide significant input. The tentative accounting rules could then be presented to the respondents in the form of scenarios illustrating the effects on the case company's own accounts of using different accounting rules. More specifically, for each area of financial reporting information sorted out in the study presented in this thesis, each respondent would be exposed to two scenarios; one scenario would show the effects of using the existing regulation/IFRS on the case company's accounts, while another scenario would show the effects of using an experimental differential rule. The respondents could then be asked to estimate the consequences of using the existing regulation/IFRS, on the one hand, and the experimental differential rule on the other.

Both in the general framework and in the project summaries that preceded the publication of the IFRS for SMEs, the IASB excludes management from the target audience of their standards. The argument is that management has the ability to determine itself the form and content of the information needed in internal decision-making. Neither does the Swedish standard setter, *Bokföringsnämnden*, include management among the main users of financial reports of smaller limited companies (K2). It is significant, however, that standard setters are aware that the design of management accounting reports, and the items that are considered significant to include in these reports, are very likely to be affected by the values that the statutory financial reports are based upon. The extent to which financial reporting information is used internally by management, and the connection between the management accounts and financial reporting information, can be further investigated using the suggested research strategy applying experimental accounting rules and scenarios.

The interviews with accounting experts constitute a primary source of empirical data in the study presented in this thesis. The accounting experts were selected from the groups of auditors, standard setters and academics. A future research project inquiring into the information needs from the perspective of managers of entrepreneurial SMEs, together with the external users of their entities' financial reports, would complement the results of the study presented in this thesis, and the two studies together would take into account the different perspectives of many significant actors of the reporting environment of

### *Conclusions and further research*

entrepreneurial SMEs. This in turn would make it possible to compare the views held by the different actors of the reporting environment, and to sort out and discuss similarities and differences, in terms of information needs and consequences of different accounting regulations in the context of entrepreneurial SMEs.



## References

- Acs, C. J., Audretsch, D. B. (2003). Innovation and technological change. In Z. J. Acs & D. B. Audretsch (Eds.), *Handbook of entrepreneurship research – An interdisciplinary survey and introduction*. Boston: Kluwer.
- Alexander, D., & Nobes, C. (2001). *Financial accounting: An international introduction*. Harlow: Pearson.
- Anthony, R. N., Dearden, J., & Govindarajan, V. (1992). *Management control systems*. Homewood: Irwin.
- Artsberg, K. (2003). *Redovisningsteori –policy och –praxis*. Malmö: Liber.
- Artsberg, K. (1995). *Accounting for public interest? – A critical investigation of the perspective of IASC*. Working paper series/Institute of economic research, 1995:8. Lund: School of Economics and management, Lund University.
- Barkham, R., Gudgin, G., Hart, M. and Hanvey, E. (1996). *The determinants of small firm growth*. Gateshead, Tyne and Wear, UK: Athenaeum.
- Beaver, W. H. (1998). *Financial reporting: An accounting revolution*. New Jersey: Prentice Hall.
- Berggren, B., Lindström G., & Olofsson, C. (2001). Tillväxt och finansiering i mindre företag. In P. Davidsson, F. Delmar & J. Wiklund (Eds.), *Tillväxtföretagen i Sverige*. Stockholm: SNS.
- Bergström, I., & Lumsden, M. (1993). *Ekonomisystem i mindre företag*. Doktorsavhandling 1993:124D, Högskolan i Luleå.
- BFN (2004a). *Ändrad inriktning på normgivningsarbetet*. Information, Dnr 28/4. Retrieved 2006-08-31, from [www.bfn.se](http://www.bfn.se)
- BFN (2004b). *International Accounting Standards Board's Discussion Paper "Preliminary Views on Accounting Standards for Small and Medium-sized Entities"*. Comment letter, Dnr 98/04. Retrieved 2006-08-31, from [www.iasb.org](http://www.iasb.org)
- BFN (2006a). *Bokföringsnämndens Allmänna Råd: K2 – Mindre aktieföretag*. Utkast. Retrieved 2006-08-31, from [www.bfn.se](http://www.bfn.se)

- BFN (2006b). *Förenklingsförslag för mindre aktiebolag*. Rapport, Dnr 28-04. Retrieved 2006-08-31, from [www.bfn.se](http://www.bfn.se)
- BFN (2007). *Bokföringsnämndens vägledning: Årsredovisning i mindre aktiebolag*. Utkast. Retrieved 080618, from [www.bfn.se](http://www.bfn.se)
- BFN (2009). *Information om K-projektet*. Retrieved 100331, from [www.bfn.se](http://www.bfn.se)
- Blomkvist, M. (2008). *Entreprenörer som redovisare: Bokslutsprocessen i gasellföretag*. Doktorsavhandling, Göteborgs Universitet. Göteborg: BAS
- Bushong, J. G. (1995). *Accounting and auditing of small businesses*. New York: Garland.
- Collier, P. M. (2005). Entrepreneurial control and the construction of a relevant accounting. *Management Accounting Research*, 16, 321-339.
- Collis, J., & Jarvis, R. (2000). *How owner-managers use accounts*. London: ICAEW.
- Cressy, R., Olofsson, C. (1996). Financial conditions for SMEs in Sweden. In R. Cressy, B. Gandemo & C. Olofsson (Eds.), *Financing SMEs – a comparative perspective*. Stockholm: Nutek.
- Dagens Industri (2009). *Mer information om DI Gasell*. Retrieved 2009-05-01, from [www.di.se](http://www.di.se).
- Davidsson, P., & Delmar, F. (1998). A taxonomy of high-growth firms. In P. D. Reynolds (Ed.), *Frontiers of entrepreneurship research* (pp. 399-413). Conference paper. Wellesley, Mass.: Babson College, 1998, pp. 399-413.
- Davidsson, P., Delmar, F., & Wiklund, J. (2002). Entrepreneurship as growth: growth as entrepreneurship. In M. Hitt & D. Ireland (Eds.), *Strategic entrepreneurship: creating a new mindset* (pp. 328-342). Oxford: Blackwell.
- Davidsson, P. & Wiklund, J. (2000). Conceptual and empirical challenges in the study of firm growth. In D. L. Sexton and H. Landström (Eds.), *Handbook of entrepreneurship* (pp 26-44). Oxford: Blackwell.
- Dergård, J. (2006). *Framgångsrika entreprenörers användning av redovisningsinformation*. Doktorsavhandling, Göteborgs Universitet. Göteborg: BAS

## References

- Dugdale, D., Hussey, J., & Jarvis, R. (1998). The statutory accounts of smaller companies: a burden or an aid to business?, *Management Accounting*, February, pp. 50-52.
- Evans, L., di Pietra, R. et al. (2005). Problems and opportunities of an International Financial Reporting Standard for small and medium-sized entities. The EAAm FRSC's comment on the IASB's Discussion Paper. *Accounting in Europe*, 2, 23-45.
- Gartner, W. B. (2001). Is there an elephant in entrepreneurship research? Blind assumptions in theory development. *Entrepreneurship Theory and Practice*, 25(4), pp. 27-39.
- Gartner, W. B. (1990). What are we talking about when we are talking about entrepreneurship?, *Journal of Business Venturing*, 5, 15-28.
- Hansen, O. B. (2005). *Regnskap og entreprenørskap: En førtolkende studie av Hvordan to entreprenører bruker regnskap*. Doktorsavhandling, Handelshøgskolan i Bodö.
- Hendriksen, E. S., & van Breda, M. F. (1992). *Accounting theory*. Homewood, Ill.; Irwin.
- Hoy, F., McDougall, P.P., and Dsouza, D.E. (1992). Strategies and environments of high-growth firms. In D.L. Sexton and J.D. Kasarda (eds.), *The state of the art of entrepreneurship*. Boston: PWS-Kent Publishing, pp. 341-57.
- IASB (2009). International Financial Reporting Standard (IFRS) for Small and Medium-sized Entities (SMEs). Retrieved 090801, from <http://www.iasb.org>
- IASB (2007a). Exposure draft of a proposed IFRS for small and medium-sized entities. Retrieved 080531, from <http://www.iasb.org>
- IASB (2006a). *Accounting standards for small and medium-sized entities (SMEs)*. Project update. Retrieved 2006-08-31, from <http://www.iasb.org>
- IASB (2006b). [Draft] International financial reporting standard for small and medium-sized entities (*IFRS for SMEs*). Retrieved 2006-08-01, from <http://www.iasb.org>
- IASB (2005). *International Accounting Standards*. London: IASB.

- IASB (2004). *Discussion paper: Preliminary views on accounting standards for small and medium-sized entities*. Retrieved 2006-08-01, from <http://www.iasb.org>
- IASB (2003). *Financial reporting by small and medium-sized entities and in emerging and transition economies*. Project summary. Retrieved 2003-09-02, from [www.iasc.org.uk](http://www.iasc.org.uk)
- IASB (2002). *Accounting by small and medium entities and emerging economies*. Topic summary. Retrieved 2003-01-09, from [www.iasc.org.uk](http://www.iasc.org.uk)
- Ireland, R. D., Webb, J. W. (2007). A cross-disciplinary exploration of entrepreneurship research. *Journal of Management*,
- Jarvis, R. (1996). *Users and uses of companies' financial statements. A literature review*. London: ICAEW.
- Johannisson, B. & Löfstäl, E. (1995). *Contrasting Business Rationales in SMEs: Appropriate Bridging Strategies*. Paper presented at RENT IX, Piacenza, Italy, November 1995.
- Johansson, C., & Samuelson, L. A. (1998). *The design and use of management accounts in small and medium-sized companies*. Working paper series in business administration no 2. Stockholm: Stockholm School of Economics.
- Johansson, S-E., & Östman, L. (1992). *Lönsambetskrav – redovisningsmitt – styrning: En behövsansats för extern och intern användning av redovisningsmått*. Lund: Studentlitteratur.
- Jönsson, S. (1988). *Role-making for accounting: The process in Sweden*. Rapport / Göteborgs universitet: Företagsekonomiska institutionen.
- Kam, V. (1990). *Accounting theory*. New York: Wiley.
- Keasey, K., & Short, H. (1990). The accounting burdens facing small firms: An empirical research note. *Accounting and Business Research*, 20(80), 307-313.
- Landström, H. (2005). *Enterprenörskapets rötter*. Lund: Studentlitteratur.
- LeCornu, M. R., McMahon, R. G. P., Forsaith, D. M., & Stanger, A. M. J. (1996). The small enterprise financial objective function. *Journal of Small Business Management*, 34(3), 1-14.

## References

- Lippitt, J. W., & Oliver, B. L. (1983). Big GAAP, little GAAP: Financial reporting in the small business environment. *Journal of Small Business Management*, 21(3), 52-57.
- Lundell, F. (2005). *Accounting and risk in the eyes of a financially successful entrepreneur*. Licentiate thesis, School of Economics and Commercial Law, Gothenburg University.
- Mathews, M. R., & Perera, M. H. B. (1996). *Accounting and theory development*. Melbourne: Nelson.
- McMahon, G. P., & Holmes, S. (1991). Small business financial management practices in North America: A literature review. *Journal of Small Business Management*, 29(2), 19-29.
- Mellemvik, F., Monsen, N., & Olson, O. (1988). Functions of accounting – A discussion. *Scandinavian Journal of Management*, 4(3/4), 101-119.
- Miller, D. (1983). The correlates of entrepreneurship in three types of firms. *Management Science*, (29), pp. 770-791.
- Olofsson, C., & Berggren, B. (1998). *De mindre företagens finansiella villkor. En replikstudie*. CEF Working Report nr 1998:102, Centrum för entreprenörskap och företagsutveckling I Uppsala.
- Olson, O., Blomkvist, M., Dergård, J., & Jönsson, C. (2003). *Accounting and entrepreneurship – A review and discussion of the scientific literature in the 80's and 90's*. Working paper. Handelshögskolan, Göteborgs Universitet.
- Page, M. J. (1984). Corporate financial reporting and the small independent company. *Accounting and business research*, 14(1984), 271-282.
- Pauli, S. (1999). *Politiker och kassaflödesrapportering – en studie av kommunpolitikens val av redovisningsinformation*. Doktorsavhandling, Göteborgs Universitet.
- Peterssohn, E. (1995). Sunda ekonomiska beslut kräver relevant information. In *Forskningsprofiler. Uppsala universitet. Installationsföreläsningar 1994/1995. Uppsala: Informationsavdelningen, Uppsala universitet*. Sid: 100-107.
- Samuelson, L. A. (1990). *Models of accounting information systems: The Swedish case*. Lund: Studentlitteratur.
- Sandin, A. (1988). Så uppstår redovisningspraxis – Dags för en uppföljning. *Balans* (5), 38-41.

- Sexton, D. L., Upton, N. B., Wacholtz, L. E., & McDougall, P. P. (1997). Learning needs of growth oriented entrepreneurs. *Journal of Business Development*, 12, 1-8.
- Shane, S., & Venkataraman, S. (2000). The promise of entrepreneurship as a field of research. *Academy of management review*, 25(1), 217-226.
- Storey, D. J. (1994). *Understanding the small business sector*. London: Routledge.
- Svensson, B. (2003). *Redovisningsinformation för bedömning av små och medelstora företags kreditvärdighet*. Doktorsavhandling, Företagsekonomiska institutionen, Uppsala Universitet.
- Thomas, A. P. (1986). The contingency theory of corporate reporting: Some empirical evidence. *Accounting, Organizations and Society*, 11(3), 253-270.
- Young, J.J. (2006). Making up Users.
- Venkataraman, S. (1997). The distinctive domain of entrepreneurship research: An editor's perspective. In J. Katz & R. Brockhaus (Eds.), *Advances in entrepreneurship, firm emergence, and growth*, vol. 3: 119-138. Greenwich, CT: JAI Press .
- Wickham, P. A. (2004). *Strategic Entrepreneurship*. Harlow: Pearson.
- Wiklund, J. (1998). *Small firm growth and performance: entrepreneurship and beyond*. Doctoral thesis, Jönköping International Business School, Jönköping University.
- Wiklund, J. & Davidsson, P. (1999). A resource-based view on organic and acquired growth. Paper presented at the Academy of Management Pre-conference. Chicago, August.
- Wiklund, J. & Shepherd, D. (2005). Entrepreneurial orientation and small business performance: a configurational approach. *Journal of Business Venturing*,

# Appendix I: Possible respondents for the interviews with accounting experts

## Swedish accounting experts

Bertil Gandemo (academic)  
Anders Bengtsson (standard setter)  
Bo Åsell (auditor)  
Dan Brännström (auditor)  
Catharina Pramhäll (standard setter)  
Caisa Drefeldt (standard setter)  
Sören Wikefelt (standard setter)  
Rolf Rundfelt (academic)  
Björn Markland (auditor)  
Ivar Verner (auditor)  
Sven-Erik Johansson (academic)  
Per Thorell (academic)  
Hans Edenhammar (standard setter)  
Jan Sundberg (trade organization)  
Hans Sjölund (auditor)  
Gunvor Pautch (standard setter)  
Birgitta Jönsson-Lundmark (academic)  
Bengt Skough (auditor)  
Sören Karlsson (standard setter)  
Rolf Törnqvist (the National Swedish Tax Board)  
Birgitta Svensson (academic)

## The IASB SME group

*Chairman:*

Thomas E. Jones, IASB Board Member

*Members:*

Yoseph Asmelash, UN's Conference on Trade and Development, Int.

Jean-Pierre Boucquet, Dexia Bank, Belgium

David Cairns, International Financial Reporting, United Kingdom

Paul Chan, Paul Chan & Partners CPAs, Hong Kong

Jérôme Chevy, Conseil national de la Comptabilité, France

*Jönköping International Business School*

Annette Davis, European Commission, Internal Market and Services Directorate General  
Mark Ellis, Michael C Fina Companies, United States  
Hugo van den Ende, PricewaterhouseCoopers, Netherlands  
Dr. Christophe Ernst, Ministry of Justice, Germany  
Ndung'u Gathinji, Eastern Central and Southern African Federation of Accountants, Kenya  
Dany Girard, Caisse Populaire Desjardins, Canada  
Frederic Gielen, The World Bank Group, International (currently seconded to UK Financial Reporting Council)  
Larissa Gorbatova, Center for Capital Market Development, Russia  
Robin Jarvis, Association of Chartered Certified Accountants, United Kingdom  
Mitsuru Komiyama, Komiyama & Co., Japan  
Pascal Labet, CGPME, France  
Ian Mackintosh, Accounting Standards Board, United Kingdom  
T. N. Manoharan, President, the Institute of Chartered Accountants of India  
Johnny Mao, The Bank of East Asia, Limited, Hong Kong SAR, China  
Reyaz Mihular, KPMG, Dubai  
Arthur V. Neis, LCS Holdings, Inc., United States  
Jan-Christian Nilsen, Danish Commerce and Companies Agency, Denmark  
Colin Notley, Mitchell Notley & Associates, New Zealand  
Enrique Ortega Carballo, Spanish Accounting and Auditing Institute, Spain  
Mike Pacitti, 3i Investments plc, Scotland, United Kingdom  
Gerhard Prachner, PricewaterhouseCoopers, Austria  
David Raggay, IFRS Consultants, Trinidad W.I.  
Dr Richard Roberts, Barclay's Bank, United Kingdom  
Leonardo Rodriguez, Florida International University, United States  
Dr Oliver Roth, LempHirz GmbH & Co. KG, Germany  
Tony Seah, SQ Morison, Malaysia  
Isobel Sharp, Deloitte & Touche, United Kingdom  
Frank Timmins, Grant Thornton, South Africa  
Saim Ustundag, Turkish Accounting Standards Board  
Ying Wei, China Accounting Standards Committee, People's Republic of China  
*Staff Contact:*  
Paul Pacter, IASB, Director, Standards for SMEs, ppacter@iasb.org

## Appendix 2: Interview questions

1. According to your opinion, who are the main users of SMEs' financial reports? For SMEs in general and for growth-oriented entrepreneurial SMEs in specific?
2. For what decision-making purposes, or in what situations, do you regard the information contained in SMEs' financial reports to be of special importance? For SMEs in general and for growth-oriented entrepreneurial SMEs in specific?
3. What kind of financial reporting information (for example what items) do you consider to be of greatest importance for the decision-making purposes, or in the situations, of question 2?
4. Swedish SMEs are according to law required to draw up annual financial reports including a profit and loss account and a balance-sheet. Do you believe that there is another form of disposition that would present the financial information to the users of entrepreneurial SMEs' financial reports in a better way?
5. If managers or owner/managers of entrepreneurial and growth-oriented SMEs were not required by law to publish financial reporting information in a certain way, what kind of information and in what form would they present this information?

## Appendix 3: Respondents to *BFN's* K2 drafts

<b>Respondents</b>	<b>Organization</b>
The Swedish Tax Authority (2006)	Government authority
SRF (2006)	Accounting firm
Företagarna (2006, 2007)	Trade organization
Sydsvenska Industri- och Handelskammarens redovisningskommitté (2006)	Trade organization
S.-I. Danielsson (2006, 2007)	Professional accountant
KPMG (2006, 2007)	Auditing firm
L. Nilsson, S.-I. Danielsson & C. Stavegren (2006, 2007)	Professional accountants
Svenskt Näringsliv (2006)	Trade organization
Revisorsamfundet (2006)	Trade organization, auditing
LRF (2006)	Accounting firm
FAR (2006)	Trade organization, auditing
FAR SRS (2007)	Trade organization, auditing
SRF (2007)	Accounting firm
Gothenburg School of Economics (2007)	Academic institution
Företagsrevision Cederlund/Grabe (2007)	Auditing firm
S.-E. Ingblad & P. Lundqvist (2007)	Academics
J. Bornhager (2007)	Academic (author of bachelor thesis)

Appendix

## Appendix 4: Respondents to the draft IFRS for SMEs

Letter	Submitter	Organization	Date
CL1	Chris Nobes	University of Reading	30/03/2007
CL2	Doug Hester		05/04/2007
CL3		Association of the Bavarian Chambers of Business, Bavarian Chamber of Industry and Commerce, Bavarian Association of Cooperatives, Association of Bavarian Savings Banks	08/05/2007
CL3A		-"-	08/05/2007
CL4	Chris Russell-Rockliff		14/06/2007
CL5	C. Morrill, J. Morrill and K. Shand	University of Manitoba	3/07/2007
CL6	Christoph Frohlich	Vienna University of Economics and Business Adm.	26/07/2007
CL7		Institute of Professional Accountants of Russia	30/07/2007
CL8		Kingston Smith LLP	3/08/2007
CL9	Mr H. J. Schadewitz	Turku School of Economics	14/08/2007
CL10		Anangu Accounting Agency	29/08/2007
CL11		CPA Australia	31/08/2007
CL11A		CPA Australia	31/08/2007
CL12		Institute of Chartered Accountants in Australia	4/09/2007
CL13	G. Ceriani & B. Fazza	University of Verona	07/09/2007
CL14		Charity Commission	10/09/2007
CL15		University of Cape Town	10/09/2007
CL16		Organismo Italiano di Contabilita	17/09/2007
CL17		Heads of Treasuries Accounting and Reporting Advisory Committee	13/09/2007
CL18	Alfredo Pignatta	Universidad de la Republica O. del Uruguay	19/09/2007
CL19	Michael Laminger	Österreichischer Raiffeisenverband	24/09/2007
CL20		Interamerican Accounting Association	24/09/2007
CL21		III WG ON IFRS IMPACT AND CBSO DATABASES	26/09/2007
CL22		Accounting Standards Board	26/09/2007
CL23		Luca Scarani	26/07/2007
CL24		Institute of Chartered Accountants of Scotland (ICAS)	28/09/2007
CL25		Fiji Institute of Accountants (FIA)	27/09/2007
CL26		The Society of Accountants in Malawi	27/09/2007
CL27		Zentralverband des Deutschen Handwerks (ZDH)	27/09/2007
CL28		Financial Executives International	27/09/2007
CL28A		Financial Executives International	30/11/2007
CL29		IBM	27/09/2007
CL30		Indonesian Accounting Standards Board	27/09/2007
CL31		Korea Accounting Association (KAA) (IFRS Review Committee)	28/09/2007
CL32		Bundesverband der Deutschen Industrie e.V. Germany	27/09/2007
CL33		JPA	28/09/2007

*Jönköping International Business School*

CL34		Leaseurope	28-sep-07
CL35		New York Society of CPA's (NYSSCPA)	28/09/2007
CL36		Institute of Chartered Accountants of Pakistan (ICAP)	30/09/2007
CL37		Iranian Institute of Certified Public Accountants	01/10/2007
CL38		[Joint] Fabrizio Cerbioni, Marco Ciabattoni, Armando Grigolon, Alessandra Mingozzi, Antonio Parbonetti, Nicola Piovan	01/10/2007
CL39		CSOEC and CNCC	28-sep-07
CL40		PKF International	28-sep-07
CL41		The Chartered Institute of Management Accountants (CIMA)	01/10/2007
CL42		AIA	01 Oct 2007
CL43		German Actuarial Association	01 Oct 2007
CL44		Dubai Financial Services Authority	01 Oct 2007
CL45		Instituto de Contabilidad y Auditoria de Cuentas ICAC	01 Oct 2007
CL46		Certified General Accountants Association of Canada	01 Oct 2007
CL47		The British Private Equity & Venture Capital Association	01 Oct 2007
CL48		Institute of Certified Public Accountants of Kenya	01 Oct 2007
CL49		The International Financial Reporting Standards review Committee of the Korean Accounting Standards Board	02 Oct 2007
CL50		Irish Banking Federation	01 Oct 2007
CL51		Korea Institute of Certified Public Accountants	01 Oct 2007
CL52		BT Group PLC	02 Oct 2007
CL53		Association of German Chambers of Industry and Commerce	02 Oct 2007
CL54		Institute of Certified Public Accountants in Ireland	02 Oct 2007
CL55		Eurochambers	02 Oct 2007
CL56		Austrian Federal Economic Chamber	02 Oct 2007
CL57		Association of Consulting Actuaries	28/09/2007
CL58		Maciej Czapiewski and Marek Dobek	04/10/2007
CL59		Italiana di Consulenze	03/10/2007
CL60		Accounting Standards Board	04/10/2007
CL61		National Cooperative Business Association	04/10/2007
CL62		Institut der Wirtschaftsprüfer (IDW)	04/10/2007
CL63		Conseil National de la Comptabilité (CNC)	04/10/2007
CL64		NIVRA	08/10/2007
CL65		National Institute of Accountants	08/10/2007
CL66		Bundessteuerberaterkammer	08/10/2007
CL67		The International Federation of Francophone Accountants (FIDEF)	09/10/2007
CL68		South African Institute of Chartered Accountants (SAICA)	09/10/2007
CL69		Zentraler Kreditausschuss	01/10/2007
CL70		Coop de France	01/10/2007
CL71		City Group P.L.C	01/10/2007
CL72		Eura Audit International	01/10/2007
CL73		ZGV	28/09/2007
CL74		Federacion de Expertos Contables y Auditores de Mesoamérica	29/09/2007
CL75		Fédération Internationale des Experts Comptables Francophones (FIDEF )	30/09/2007
CL76		La Contaduría Pública en Venezuela	01/10/2007

### Appendix

CL77		African Consulting Enterprise	01/10/2007
CL79		Comentarios del Colegio de Contadores Públicos de Colombia al proyecto de norma, Norma Internacional de Información Financiera para Pequeñas y Medianas Entidades Colombia	01/10/2007
CL80		Consejo De Vigilancia De La Profesion De Contaduria	01/10/2007
CL81	Eugenio Rodriguez Mite	Instituto de Investigaciones Contables del Ecuador	01/10/2007
CL82		The School of Accounting of the University Pedagogic and Technologic of Colombia	01/10/2007
CL83		Conselho Federal de Contabilidade (CFC)	01/10/2007
CL84		Malaysian Accounting Standards Board (MASB)	12/10/2007
CL85		American Institute of Certified Public Accountants	15 Oct 2007
CL86		Ernst & Young	17/10/2007
CL87		CFA Institute	17/10/2007
CL88		Instituto de Censores Jurados de Cuentas de Espana (ICJCE)	17/10/2007
CL89		Institute of Chartered Accountants in Ireland (ICAI)	22/10/2007
CL90		Mouvement des Entreprises de France (MEDEF)	23/10/2007
CL91		DFCG (French Association of Financial Executives)	23/10/2007
CL92		Grant Thornton International	26/10/2007
CL93		Consiglio Nazionale dei Dottori Commercialisti and the Consiglio Nazionale dei Ragionieri	25/10/2007
CL94		DATEV eG	25/10/2007
CL95		KPMG	29/10/2007
CL96		The Dutch Accounting Standards Board (DASB)	30/10/2007
CL97		National Accounting Standards Board of Russia (NASB)	31/10/2007
CL98		Ataf Noor Ali Chartered Accountant	04/11/2007
CL99		F G S Flick Gocke Schaumburg	05/11/2007
CL100		Association of Accounting Technicians	09/11/2007
CL101		CILEA	08/11/2007
CL102		The Society of Chinese Accountants and Auditors	10/11/2007
CL103		GNC	14/11/2007
CL104		Financial Reporting Standards Board (FRSB)	14/11/2007
CL105		VMEBF	15/11/2007
CL106	WaiChan Chan		15/11/2007
CL107	Tim Matthews		20/11/0007
CL108	Yoyo Mui		20/11/2007
CL109		Philippine Financial Reporting Standards Council (PFRSC)	22/11/2007
CL110		British Accounting Association's Financial Accounting and Reporting Special Interest Group	26/11/2007
CL111		Eastern, Central and Southern Federation of Accountants (ECSAFA)	26/11/2007
CL112	J. Morrill and C. Morrill	University of Manitoba	26/11/2007
CL113		Association Francaise des Investisseurs en Capital (AFIC)	26/11/2007
CL114		Deloitte Touche Tohmatsu	27/11/2007
CL115		Australian Accounting Standards Board	28/11/007
CL132		DGRV e.V.	30/11/2007
CL116		Foreningen af Statsautoriserede Revisorer (FSR)	28/11/2007
CL117		International Controllers Association (ICA)	28/11/2007
CL118		Association of Chartered Certified Accountants (ACCA) (UK)	29/11/2007
CL119	P.A. Pieterse van Wijck		29/11/2007

*Jönköping International Business School*

CL120		BSDG and CMFB	29/11/2007
CL121		Norwegian Accounting Standards Board	29/11/2007
CL122		Japanese Institute of Certified Public Accountants	30/11/2007
CL123		Cooperatives Europe	30/11/2007
CL124		INAA	30/11/2007
CL125		EAA FRSC	30/11/2007
CL126		Institute of Chartered Accountants in India	30/11/2007
CL127		Danish Companies and Commerce Agency	30/11/2007
CL128		National Board of Accountants and Auditors(NBAA)	30/11/2007
CL129		C. Hecht, D&L GmbH, BPG GmbH, Treuh.-ges. Herrmann GmbH	30/11/2007
CL130		CINIF	30/11/2007
CL131		Federacion Argentina de Consejos Profesionales de Ciencias Economicas	30/11/2007
CL132		DGRV e.V	30/11/2007
CL133		Confederation of British Industry (CBI)	30/11/2007
CL134		CAPA	30/11/2007
CL135		BDO International	30/11/2007
CL136		Institute of Chartered Accountants of Jamaica	30/11/2007
CL137		PricewaterhouseCoopers	30/11/2007
CL138		Working Party of Dottori Commercialisti in Milano	30/11/2007
CL139		Institute of Certified Public Accountants in Israel ICPAI	30/11/2007
CL140		Hong Kong Institute of Certified Public Accountants	03/12/2007
CL141		ASEAN Federation of Accountants (AFA)	03/12/2007
CL142		International Federation of Accountants (IFAC)	03/12/2007
CL143		International Co-operative Alliance	03/12/2007
CL144		Canadian Accounting Standards Board	03/12/2007
CL149		FAR SRS -The Institute for the Accountancy Prof.	06/12/2007
CL145		Zambia Institute of Chartered Accountants	03/12/2007
CL146		Family Entrepreneurs – ASU	03/12/2007
CL147		Den Norske Revisorforening (Norwegian Institute of Public Accountants)	04/12/2007
CL148		BHP Billiton	05/12/2007
CL150		Institute of Chartered Accountants of Barbados	06/12/2007
CL151		Association of Finnish Accounting Firms	10/12/2007
CL152		Sunil Goyal - S.R.Goyal & Co., Chartered Accountants	06/12/2007
CL153		Austrian Financial Reporting and Auditing Committee (AFRAC)	10/12/2007
CL154		Securities and Exchange Commission	12/12/2007
CL155	Paul H Nettleship		01/10/2007
CL156		London Society of Chartered Accountants (LSCA)	14/12/2007
CL157		United Nations Conference on Trade and Development (UNCTAD)	14/12/2007
CL158		Collegio de Contadores Publicos de Costa Rica (Institute of Public Accountants of Costa Rica)	14/12/52008
CL159		Ordre des Experts Comptables de Tunisie	14/12/2007
CL160		German Accounting Standards Committee (DRSC)	14/12/2007
CL161		European Financial Reporting Advisory Group (EFRAG)	11/02/2008
CL162		Mazars	30/11/2007

## JIBS Research Reports

- (1998-1) Nilsson, Ulf: *Produktkalkyleringens utformning och användning hos en mindre underleverantör i fordonsbranschen*, Licentiatuppsats i företagsekonomi
- (1999-1) Florin Samuelsson, Emilia: *Redovisning och små växande familjeföretag*, Licentiatuppsats i företagsekonomi
- (1999-2) Forsberg, Svante: *Centerpartiet - hemvist i stad eller land? En studie av centerpartiets interna diskussion om val av strategi gentemot väljarna 1958 – 1973*, Licentiatuppsats i statskunskap
- (1999-3) Samuelsson, Mikael: *Swedish Family and Non-family Enterprises - Demographic and Performance Contrasts*
- (1999-4) Samuelsson, Mikael: *Swedish Family and Non-family Enterprises - Demographic and Performance Contrasts: A Multivariate Approach*
- (1999-5) Hansemark, Ove C: *Teoretiska, metodologiska och praktiska problem kring entreprenörskap och trait-ansatsen*, Licentiatuppsats i företagsekonomi
- (1996-6) Salvato, Davidsson & Persson (eds.): *Entrepreneurial Knowledge and Learning. Conceptual advances and directions for future research*
- (2000-1) Jonson Ahl, Helene & Florin Samuelsson, Emilia: *Networking through empowerment and empowerment through networking*
- (2000-2) Karlsson, Tomas & Junehed, Johan: *Entrepreneurial opportunity development – Describing and comparing opportunity development processes in small firms experiencing high growth*
- (2000-3) Blombäck, Anna: *Growth and risk-taking behaviour in SMEs*
- (2000-4) Eriksson, Agndal, Brunninge, Bäckström & Karlsson: *Jönköpingsregionens näringsliv - Dynamik, drivkrafter och samverkan*
- (2001-1) Bruns, Volker: *A dual perspective of the credit process between banks and growing privately held firms*, Licentiate thesis in Business Administration
- (2001-2) Nilsson, Rolf: *Agglomeration Economies and Specialisation in Functional Regions in Sweden*, Licentiate thesis in Economics
- (2002-1) Salvato, Carlo: *Antecedents of Entrepreneurship in Three Types of Family Firms*
- (2002-2) Kjellgren, Jonas: *Essays on Agglomeration and Sectoral Diversification in Sweden*, Licentiate thesis in Economics
- (2002-3) Kyrö, Paula: *Benchmarking Nordic statistics on woman entrepreneurship*

Jönköping International Business School

- (2002-4) Agndal, Henrik and Axelsson, Björn (eds.): *Networks and Business Renewal*
- (2003-1) Alberti, Fernando: *What makes it an industrial district? - A cognitive constructionist approach*
- (2004-1) Eliasson, Christian: *Corporate entrepreneurship: A longitudinal study of determinants and consequences of resource recombinations in existing organizations*, Licentiate thesis in Business Administration
- (2004-2) Picard, Robert G. (ed.): *Strategic Responses to Media Market Changes*, Media Management and Transformation Centre
- (2004-3) Andersson, Martin: *Studies of Knowledge, Location and Growth*, Licentiate thesis in Economics
- (2004-4) Sciascia, Salvatore (ed.): *Exploring Corporate Entrepreneurship. Entrepreneurial Orientation in Small and Medium sized Enterprises*
- (2005-1) Picard, Robert (ed.): *Corporate Governance of Media Companies*, Media Management and Transformation Centre
- (2005-2) Dal Zotto, Cinzia (ed.): *Growth and Dynamics of Maturing New Media Companies*, Media Management and Transformation Centre
- (2005-3) Larsson, Johan: *Development of suppliers and supply chains – Supplier development as a purchasing strategy*, Licentiate thesis in Business Administration
- (2005-4) Hill, Annette: *Audiences and Factual and Reality Television in Sweden*, Media Management and Transformation Centre
- (2006-1) Küng, Lucy (ed.): *Leadership in the Media industry – Changing Contexts, Emerging Challenges*, Media Management and Transformation Centre
- (2006-2) Gustafsson, Karl Erik: *Lokalmediestudier*, Media Management and Transformation Centre
- (2006-3) van Weezel, Aldo: *Financial and Strategic Position of Nordic Media Companies*, Media Management and Transformation Centre
- (2007-1) Achtenhagen, Leona (ed.): *Organizing Media: Mastering the Challenges of Organizational Change*, Media Management and Transformation Centre
- (2008-1) Ots, Mart (ed.): *Media Brands and Branding*, Media Management and Transformation Centre
- (2008-2) Humphreys, Edward (ed.): *International Copyright Law and Media Content Producers*, Media Management and Transformation Centre
- (2008-3) Eriksson, Sören: *Varför producera utomlands? 11 fallstudier från Jönköpings län om outsourcing och offshoring*

JIBS Research Reports

- (2009-1) Karlsson, Peter: *On the Asymptotics of Increasing Dimension Models – Methods for Complete or Incomplete Data*, Licentiate thesis in Economics
- (2009-2) Gustafsson, Karl Erik (red.): *Hamrin Symposium 2008*, Media Management and Transformation Centre
- (2010-1) Johansson, Börje; Klaesson, Johan; Andersson, Martin; Forslund, Ulla; Strömquist, Ulf: *Storstadsregionerna och ekonomins utveckling*, CESIS och Internationella Handelshögskolan i Jönköping
- (2010-2) Sundin, Ebba: *Brand New Planet – A Canadian Newspaper Project for Children*, Media Management and Transformation Centre
- (2010-3) Yström, Annika: *Financial reporting in entrepreneurial SMEs: In search of significant areas of financial reporting information*, Licentiate thesis in Business Administration