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THE ROLE OF THE CASH BASIS IN LIMITED PURPOSE FINANCIAL REPORTING

by

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requirements for the
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ABSTRACT

The strictly regulated environment within which corporate accounting practice evolves, has traditionally paid little attention to the owner-managed corporation and the specific information needs of its owners. The literature, as well as recent corporate law amendments, though, hints strongly that owner-managed entities have different financial reporting priorities than their publicly accountable counterparts. This difference in financial reporting priorities calls for rethinking at the most fundamental level of financial reporting, i.e. accrual versus cash-basis financial reporting. This implies that the debate about the extent of sophistication that should be built into the accrual-basis model can only be conducted sensibly after the primary debate of accrual versus cash-basis, is resolved satisfactorily. The question as to whether measurement and recognition criteria within an accrual-basis model should be relaxed is therefore part of the secondary debate. The basic research question relates to the usefulness to owner-managers of cash-basis accounting compared to accrual-basis accounting.

This thesis reports on the responses of 243 practising members of the South African Institute of Professional Accountants (SAIPA) regarding owner-manager needs and preferences regarding financial accounting recording and reporting practices. Semi-structured interviews were conducted with owner-managers to verify the understanding of the practitioners regarding owner-manager needs and preferences.

The results showed and explained an apparent paradox: owner-managers have a strong cash focus in the way they understand and use financial information, but nevertheless prefer accrual-basis annual financial statements.

The unresolved challenge identified by this study is to design a financial report which could better bridge the gap between accrual-basis and cash-basis accounting than the conventional statement of cash flow.

DECLARATION

I declare that The role of the Cash Basis in Limited Purpose Financial Reporting is my own work, that it has not been submitted before for any degree or examination in any other university and that all the sources I have used or quoted have been indicated and acknowledged as complete references.

Willem A Lötter

March 2010

Signed: _____

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- My wife and family for their support, especially during the final phase of this thesis.

DEDICATION

I dedicate this thesis to my wife Hanlie

for

the constant encouragement she gave me by giving up precious family time to help me accomplish my goal, but also for providing me with a purpose to chase the goal.

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DEFINITIONS

In this thesis, unless specifically indicated otherwise, the terms below are used in the context of the following definitions:

Term	Definition
Accrual-basis of accounting	An approach towards accounting according to which financial statements are prepared using income, expenses, assets, liabilities and equity reflecting transactions resulting from all resources created and utilized. In a small entity setting, the recording of transactions is often still done on a cash basis, while information is converted to the accrual basis by processing year-end accrual-basis journal entries into the system.
Accruals	Transactions not involving cash.
Cash	Cash and cash equivalents
Cash-basis of accounting	An approach towards accounting according to which only cash transactions are recorded and financial statements prepared using only cash information.

<p>Simple accrual-basis</p>	<p>In its pure form, cash is the only asset recognized and a bank overdraft the only liability, resulting in other assets and liabilities incurred in a particular reporting period being written off in that period.</p> <p>An approach towards accounting according to which financial statements are prepared using income, expenses, assets, liabilities and equity reflecting all cash transactions as well as selected accruals (certain resources over and above cash created and utilized). Only accruals perceived by the preparer of the financial statements to enhance the usefulness of the financial statements considerably, considering the cost of such information are taken into account.</p>
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LIST OF ACRONYMS

<u>AAA</u>	The American Accounting Association
<u>AICPA</u>	American Institute of Certified Public Accountants
<u>AFS</u>	Annual financial statements
<u>APB</u>	Accounting Practices Board
<u>GAAP</u>	Generally Accepted Accounting Practice
<u>IAS</u>	International Accounting Standards
<u>IASB</u>	International Accounting Standards Board
<u>IFAC</u>	International Federation of Accountants
<u>IFRS</u>	International Financial Reporting Standards
<u>IPSAS</u>	International Public Sector Accounting Standard
<u>IWG</u>	Intergovernmental Working Group of Experts on International Standards of Accounting and Reporting. The group forms part of the Trade and Development Board of the United Nations.
<u>OCBOA</u>	Other Comprehensive Basis of Accounting. The term was generated in a USA context, indicating an acceptable alternative to GAAP for unlisted Companies.

<u>PSC</u>	Public Sector Committee (a standing committee of IFAC)
<u>SAICA</u>	South African Institute of Chartered Accountants
<u>SAIPA</u>	South African Institute of Professional Accountants. The institute had a name change in 2006. The previous name was the Institute of Commercial and Financial Accountants of Southern Africa (CFA).
<u>SBEs</u>	Small business enterprises
<u>SMEs</u>	Small and medium sized enterprises

1 INTRODUCTION

Differential reporting is “the notion that some entities should be allowed to depart from particular requirements of accounting standards or entire accounting standards in preparing their financial statements” (HKSA, 2002:5). Edwards (2004: 38) argued that differential reporting is justified for some entities, because they have a smaller number of users, who often have access to information beyond the financial statements, and the cost of compliance with accounting standards exceeds the benefits thereof for the users of the financial statements.

Lennon and Sharp (1998:7) wrote the following in the context of the development of differential reporting in the UK: “If a clean start could be made to design small company reporting from scratch, then perhaps the cash flow statement would be the only one that was required, with information on other items given in notes.” They made this observation in the context of the evolution of financial reporting, fueled by numerous accounting standards and corporate law developments, which keep on complicating financial reporting.

Loyd C Heath (1987: 51) wrote: “Historically, cash-basis accounting preceded accrual accounting. Accountants fought for years to gain acceptance of the idea that accrued expenses are real expenses and should be deducted from revenue when measuring income even though they do not result in cash outflows in the current year.” He stated further that some accountants now “regard the reporting of cash flows as a throwback to cash-basis accounting and a challenge to the supremacy of accrual-basis income statements rather than as complementary to them.” Board and Day (1989: 10) observed in the same context that the mere conventional confidence in historical cost earnings as a predictor of capital market behaviour distorted the results of perception studies trying to demonstrate cash flow measures as equal or superior to accrual accounting measures.

It is therefore not surprising that the exposure draft on differential reporting issued in South Africa in 2003 (SAICA, 2003a), took the existing full Generally Accepted

Accounting Practice (GAAP) model of the time as the departure point, considering certain differential reporting concessions with reference to the complete model, instead of simplifying the underlying basis of financial reporting.

During the seventies, eighties and nineties, much was written to justify the cash flow statement as a statement of measuring both financial performance and liquidity, especially by Lawson (1972a and b; 1978) and Lee (1972; 1983). This debate influenced standard setters to the extent that accounting standards were adjusted to provide for cash flow statements to replace other forms of fund statements, hence acknowledging the importance of cash flow information to users of accrual-basis financial statements.

The Intergovernmental Working Group of Experts on International Standards of Accounting and Reporting (United Nations, 2001: 4), a task team of the Trade and Development Board of the United Nations, proposed guidelines for a tiered differential reporting framework, including a suggestion for a cash-basis model at the lowest tier. The Working Group stated clearly, though, that such a framework must be coherent enough to allow a logical progression from the most unsophisticated tier to the most sophisticated tier of financial reporting (United Nations, 2001: 11).

An exposure draft “IFRS for Small and Medium-sized Entities”, was released by the International Accounting Standards Board in 2007, providing for only a second tier of financial reporting (IASB, 2007). Even before the release of the exposure draft, the International Federation of Accountants (IFAC) commissioned an investigation into the preparers and users of micro-entity financial reports, and their information needs. The empirical evidence of the study was published in 2008, making only broad recommendations regarding a possible third tier of financial reporting applicable to micro entities (IFAC, 2008). These recommendations are discussed in chapter 3.

In this study, the focus is on the financial statements of owner-managed entities and their users, especially owner-managers. Literature regarding the users of small and medium entities and their needs was therefore consulted. The study attempted to

determine whether owner-managers themselves are indeed important users of financial statements and what they are using the financial statements for.

One of the key questions examined in this study is whether the cash basis, as Lennon and Sharp (1998) implied, could indeed be a tool to solve aspects of the differential reporting debate. For this purpose, literature regarding the merits of cash flow information and its ability to be used for performance measurement has also been reviewed. Furthermore, the understanding by owner-managers of accrual-basis financial statements, the role of cash flow information in their financial decision-making and whether cash-basis financial statements would be more useful to them instead of accrual-basis financial statements, formed part of the study.

2 REVIEW OF THE LITERATURE: THE BACKGROUND TO DIFFERENTIAL REPORTING

2.1 Introduction

In July 2001, the Intergovernmental Working Group (IWG) issued a report to be used as a guideline by countries in their endeavours to address the differential reporting problem (United Nations, 2001). These guidelines were formulated by an ad hoc consultative group of experts on accounting by small and medium sized enterprises. In the executive summary of the report of the consultative group (United Nations, 2001: 1), the task of the group was explained as follows: "It (the IWG) recognized that in most member states, SMEs were required to conduct their accounting and reporting on the basis of standards that were originally intended for larger companies that were often listed on stock markets. Therefore, the session called for ad hoc expert consultations to be conducted with a view to formulate recommendations on a financial accounting and reporting framework, appropriate for SMEs."

The criteria suggested by the IWG to classify entities into different financial reporting tiers, were intended to be broad guidelines to national standard setters, rather than rigid blueprints.

The generic guidelines captured in the report of the IWG, some background material from cash flow literature, as well as a brief history of differential reporting in South Africa, will be discussed in this chapter.

2.2 The justification for differential reporting

In paragraph 8 of the Accounting Framework (AC000) (SAICA, 1990), a reporting enterprise was defined, at the time, as "... an enterprise for which there are users who rely on the financial statements as their major source of financial information about the enterprise." The necessity for such reporting enterprises to prepare general purpose financial statements in full compliance with Generally Accepted Accounting Practice

(GAAP), is clear in view of their public accountability. This connection between the user base of an entity and the need for general purpose financial statements is also emphasized in paragraph one of the international conceptual framework (IASB, 2001), stating that the framework “sets out concepts that underlie the preparation and presentation of financial statement for external users.”

The IWG (United Nations, 2001: 4) confirmed the above view by proposing criteria for their suggested first tier of financial reporting (the full GAAP tier), which are in essence indicators of public accountability. The criteria are as follows:

- the entity issues public securities, or
- it enjoys significant public interest (including large employment), or
- it is a bank or financial institution (by nature these institutions evoke public interest).

Debate, however, had been triggered concerning justification for deviation from GAAP for entities that lacked public accountability. In various countries the accounting profession has identified the need for differential reporting and has recommended a two tier financial reporting system. The two tiers were mainly distinguished according to entity size and the nature of the users of the financial statements (and thus the amount of public accountability required) of the entities (John & Healeas, 2000; HKSA, 2002; SAICA, 2003a and b). It is therefore appropriate to refer to the product of differential reporting as Limited Purpose Financial Statements (also in view of the distinction made between “widely held” and “limited interest” companies in the Corporate Laws Amendment Act of 2006).

The IWG report (United Nations, 2001: 5) recommended an additional, third tier of financial reporting. This recommendation was influenced by the IWG’s interpretation of specific financial reporting needs of small enterprises, as discussed below.

2.2.1 *Small and Medium Enterprises*

The IWG referred collectively to small and medium enterprises (SMEs) to describe the kind of entity in need of differential reporting.

In 1996, the European Commission set out a definition of SMEs based on number of employees, maximum annual turnover, maximum annual balance sheet total, and level of independence from institutional shareholders (Jones & Tillay, 2003: 2). The definition was updated in 2005. The 2005 definition (IFAC, 2006: 25) is summarized in the following table:

Table 2.1: *A definition of SMEs in tabular form*

Criterion	Micro firm	Small firm	Medium firm
Maximum number of employees	10	50	250
Maximum annual turnover	2 m euros	10 m euros	50 m euros
Maximum annual balance sheet total	2 m euros	10 m euros	43 m euros
Maximum % owned by enterprise(s) not satisfying the same criteria.	-	25%	25%

The above definition includes a wide range of entities in terms of size and nature of ownership. It therefore stands to reason that the IWG held the view that a second tier of financial reporting would not be adequate to accommodate the financial reporting needs of micro, small and medium firms. Their suggested third tier therefore implied that the three groupings above should at least split into two distinguishable tiers, each with its own differential reporting requirements.

2.3 **The nature of differential reporting**

2.3.1 *The nature of second tier financial reporting*

The IWG adopted the UK approach to a differential accounting standard, being a separate standard. The UK Financial Reporting Standard for Small Enterprises

(FRSSE) is a subset of full UK GAAP; likewise the proposed International Accounting Standard for Small and Medium Enterprises (IASSME), at the time, would have been a subset of International Accounting Standards (IAS). These separate standards would comprise all the elements of the respective “main accounting standards” that were likely to be encountered by small entities (United Nations, 2001: 6).

According to the recommended approach, all transactions or situations not covered by the standard for differential reporting should be disclosed in compliance with the appropriate first tier (full GAAP) accounting standard. The fact that an entity complied with IASSME and not full IAS, should be mentioned in an accounting policy note.

The terms of reference of the IWG made it clear that coherency should be established at all levels; hence, recognition and measurement standards should be retained as far as possible, while differentiation should rather be applied in the following ways:

- to exempt accounting standards as a whole, in respect of those standards very unlikely to be relevant to the economic realities of a typical second tier entity (United Nations, 2001: 7)
- to exempt or simplify disclosures in respect of accounting standards regarded as relevant to a second tier entity (United Nations, 2001: 9)

This second tier essentially represented the larger SMEs. The criterion distinguishing them from the first tier was that the entity neither issues public securities nor financial reports to the general public, which is a criterion of public accountability.

The proposed criteria to distinguish the second tier from the third tier were:

- the entity employs in-house accounting expertise (a criterion of capacity and cost-benefit) and
- the entity has more than just a few employees (a criterion of size and public accountability) (United Nations, 2001: 5)

Entities meeting these criteria would fall within the second tier.

2.3.2 The nature of third tier financial reporting

The third tier recommended by the IWG would represent the numerous smaller SMEs. The IWG (United Nations, 2001: 10) made their recommendations on the accounting specifications of a third tier, considering specifically:

- the simplicity of the business transactions
- the lack of resources
- the limited in-house accounting expertise
- management, tax officials, creditors and investors as the targeted users.

The proposed criteria for an entity to qualify for this tier were:

- the entity has to be owner-managed (reducing public accountability) and
- the entity should not have more than only a few employees (a size and public accountability criterion) and
- the entity should not be able to afford in-house accounting expertise, which is a criterion of capacity and cost-benefit (United Nations, 2001: 10).

The IWG recommended a simple accrual accounting approach for the third tier. This (cost-based) accruals approach, would not seek compliance with international standards in general. Related requirements would be:

- to apply the matching principle
- not to allow any offsetting of related items
- to follow models of charts of accounts and model financial statements (for different types of industries)
- to provide columns in the model income statement to allocate income and expense items to different product streams, as well as a column for “unallocated” items (United Nations, 2001: 10).

Model financial statements were included as part of the package to encourage owner-managers to think analytically about their businesses (United Nations, 2001:11).

The allocation to different product streams is seen to be a step in the direction of providing some management information for internal decision-making.

What emerges from this is that, unlike the “full standards less some exemptions” model of differential reporting, this proposed third tier model sought to adhere to basic accounting principles and allows space for rethinking presentation of financial statements to be conducive to the specific needs of its users.

The Ministry of Economic Development of New Zealand (New Zealand, 2002) touched on some questions regarding SMEs which appear to be relevant in considering whether a third tier of financial reporting is justified. These questions were:

- Do owner-managers really need financial statements for strategic business decisions?
- Should lack of financial knowledge play a role in determining the specifications of financial statements?
- Do creditors and lenders really rely on financial statements to determine financial risk?
- Is the cost of financial statements balanced by the benefits derived from their usage?
- Do financial statements foster a form of financial discipline in an SME?

The IWG (United Nations, 2001:11), went a step further and identified two categories of entities which needed an approach to financial reporting, scaled down even more than what is suggested for tier three, although they did not classify it as a separate tier.

The two categories are:

- micro entities, starting up and
- micro entities moving from the informal to the formal sector

Such entities, according to the IWG, needed a transitional approach to financial reporting, comprising the following elements:

- a cash basis of recording transactions
- matching of revenue and expenses to different periods would not be required
- no fixed assets would be recognised

- some periodic balances, such as inventory and accounts receivable, may be recognised.

The scaled down approach discussed above is therefore in essence a cash basis approach to which selective accruals are applied. The basis of selection of specific accruals was not discussed in the IWG document, but it appears if the intention was to include accruals, the information of which was easily accessible, for example by an inventory count or by adding up outstanding sales invoices. This suggested approach apparently has much in common with so-called “other comprehensive basis of accounting” which is discussed later in this chapter.

The suggested three tiers are summarized in the following table:

Table 2.2: Key differences amongst tiers of financial reporting

Issue considered	Tier 1	Tier 2	Tier 3
Wide user base?	Yes	No	No
Accountable to Public?	Yes	Partially because of size	No
Owner-managed?	No	Yes	Yes
Size?	Large	Larger SMEs	Smaller SMEs
In-house accounting expertise?	Yes	Yes	No
Compliance with IFRS justified?	Yes	Some exclusions	No, only simple accrual-basis principles applied
Micro entities starting up / moving from informal to formal sector	N/A	N/A	Cash basis

The early ideas captured in the work of the IWG are of key importance in this study, because later debate on differential reporting drifted more and more towards differential reporting in the sense of differentiation from a full body of accounting standards as opposed to the acknowledgement of the need for a tier for which the reporting requirements are really basic. It was only with the release of the IFAC reports on Micro

Entity Financial Reporting (IFAC 2006 and 2008) that attention focused again on the necessity of a third tier of financial reporting.

2.4 The cash basis in financial reporting

2.4.1 Cash basis and cash flow

In accounting terms, “cash basis” is generally used in the context of transactions being recorded only when cash is received or paid instead of when resources are created or utilized, as in an accrual-basis system. Cash-basis financial records can be used to prepare a simple receipts and payments statement or, if in a double entry system, a cash-based income statement and a balance sheet reflecting cash as only asset. The same information may also be used to prepare a statement of cash flow, reflecting operating, investing and financing activities measured in cash terms. A statement of cash flow, however, can also be prepared from accrual-basis financial statements, by undoing the accrual-basis elements of financial statements. In paragraph 19 of International accounting standard on Statements of Cash Flows (IASB, 2009), it is stated that statements of cash flows can be prepared from either accounting records (by implication movements on the bank account) or by adjusting accrual-basis accounting figures.

In Annexure 7, the transactions of a small hypothetical entity for three reporting periods is presented on both the accrual-basis and the cash basis to illustrate the conceptual difference between the two bases, and to show that income statements and balance sheets prepared on either of the bases can be used to prepare a statement of cash flow. The only real difference is that the cash basis would not enable the preparer to reconcile accrual-basis profit and cash generated from operations, since accrual-basis profit would not be determinable in a cash-basis system.

Furthermore, the preparation of statements of cash flow from either accrual-basis or cash-basis information is evident from recent developments in the public sector. In 2003, the Public Sector Committee (PSC), a standing committee of the International

Federation of Accountants (IFAC), issued an International Public Sector Accounting Standard (IPSAS) titled “Financial Reporting under the Cash Basis of Accounting” (IPSAB, 2007). This standard on the cash basis of accounting followed an in-principle decision by the PSC that public sector entities should adopt the accrual-basis of accounting. This was on the grounds that the accrual basis would generate better quality financial information than other bases of accounting and that accrual-basis information was necessary for the discharge of accountability. Furthermore, it would support transparency in financial reporting and enable better decision-making by internal management (Sutcliffe, 2002:1). Cash-basis accounting and modified cash-basis accounting, however, was so widely adopted for financial reporting by governments that the cash-basis standard was adopted to strengthen cash-basis reports issued and to guide a transition from the cash basis to the accrual basis (Sutcliffe, 2002:8). It is noteworthy that the PSC preferred a statement of cash flows format comparable to that of statements of cash flow prepared under the accrual basis, distinguishing the cash effect of operating, investing and financing activities (Sutcliffe, 2002:8).

Statements of cash flow can be prepared from cash-basis accounting records or cash basis financial statements. The usefulness of statements of cash flow to the users of financial statements, might therefore also apply if a cash-basis recording system is used.

Although literature on the usefulness of statements of cash flow for entities operating in commerce and industry was written in the context of statements of cash flow being part of accrual-basis financial statements, such literature may be useful in assessing the merits of a cash-basis accounting system and is therefore included in this review.

2.4.2 Statements of cash flow

Paragraph 4 of IAS 7 on statements of cash flow (IASB, 2009), states that “... economic decisions that are taken by users require an evaluation of the ability of an enterprise to generate cash and cash equivalents, and the timing and certainty of their

generation.” Statements of cash flow provide historical cash flow information which is an important ingredient in such evaluations of future cash flows.

2.4.3 Solvency and liquidity considerations

The conceptual framework (IASB, 2001: paragraph 16) defines both solvency and liquidity in terms of “availability of cash”, being availability of cash over the longer term, for solvency, and availability of cash in the near future, for liquidity. Both the Companies Act of 1973 (South Africa, 1973) and the Corporate Laws Amendment Act (South Africa, 2006) viewed solvency as the condition when assets, fairly valued, are more than the liabilities, while liquidity is seen as the ability of a company to pay its debts in the ordinary course of business. According to Loftus and Miller (2000:1) however, solvency indicates an entity’s capacity to pay debts as they fall due, while liquidity emphasizes the “nearness to cash” of assets. Solvency therefore requires synchronization of cash inflows and cash outflows (Loftus and Miller, 2000: 29). The mere fact that an entity’s assets exceed its liabilities, accordingly, is not generally sufficient to establish solvency. If, on the other hand, it is clear that actual cash resources (plus unused credit resources) are sufficient to cover actual debts that fall due, true solvency has been established. Notably, IAS 7, on statements of cash flow, encourages the disclosure of undrawn borrowings and the restrictions on the use thereof (IASB, 201: paragraph 50).

Loftus and Miller (2000: 35) confirm that many users of financial statements are concerned about the ability of an entity to survive. They pointed out, though, that the use of accrual accounting and the frequent use of profit figures have resulted in less attention been given to the timing and degree of uncertainty of cash flows. The Ministry of Economic Development of New Zealand (2002: 9) observed that SMEs are more reliant on accounts payable and bank overdraft facilities and less reliant on shareholders’ funds as source of finance for assets, resulting in high gearing ratios. This observation implies that liquidity and solvency considerations could be of key importance to SMEs.

Solvency and liquidity must therefore be taken into account in considering the needs of owner-managers of owner-managed entities and the resulting choice between the cash basis and accrual basis in accounting.

2.4.4 The role of cash-basis accounting in the USA context

In an Information Paper issued by the International Federation of Accountants (2006: 28) the USA approach is described as follows: "Probably the simplest basis of differentiation between types of entities is found in the USA. Entities that fall within the jurisdiction of the SEC, as they list public debt or equity, must comply with full US GAAP requirements in the form of FASB pronouncements. Other entities need not produce such statements, although many especially of the larger entities do produce GAAP statements as those are demanded by various users." Unlisted companies are therefore left with considerable discretion regarding a choice of the most appropriate accounting basis.

As far back as 1976, the accounting profession in the USA accepted the so-called Statement on Auditing Standards 14, Special Reports, giving guidelines on the audit of so-called "other comprehensive basis of accounting" (OCBOA) financial statements. These OCBOA financial statements comprised the cash basis, the modified cash basis and the income tax basis. In 1981, the Special Committee on Accounting Standards Overload of the American Accounting Association (AAA), recommended the use of the income tax basis of accounting (the details of this method are described below) to provide immediate short term relief to the standards overload problem for those situations where GAAP financial statements were not necessary (Hepp and McRae, 1982: 56).

The two most common "other comprehensive basis of accounting" used in the USA at the time were the modified cash basis and the tax basis (Alderman, 1982: 53).

A general principle accepted in the modified cash basis (a hybrid cash-accrual-basis), is that the accrual basis can be applied in respect of a particular item, providing the method is not illogical, e.g. recording sales on an accrual basis and recording purchases on a cash basis would not be logical.

The following modifications to the strict accruals basis were recognised in practice in the USA, enjoying "substantial support" (which was a prerequisite for a basis to be classified as OCBOA). Recording and stating in the financial statements:

- only property, plant and equipment purchased for cash
- accumulated depreciation (on only the recorded property, plant and equipment)
- only inventory purchased for cash
- only liabilities arising from the receipt of borrowed cash (Alderman, 1982: 53).

The general principle underpinning this approach was that an asset or liability is only raised if its contra entry is cash. Land financed with a mortgage bond would therefore not be captured as a transaction in this method, unless the cash flow reflected in the bank. If, to the contrary, the bond proceeds were paid into the business bank account and afterwards drawn to pay for the land, both the mortgage bond liability and the land asset would reflect in the balance sheet.

In the case of tax-basis financial statements, the measurement standards prescribed by tax legislation would also be applicable to the financial statements. Within this basis, the cash, full accrual, or modified accrual approaches could be accommodated. The main advantage of the tax basis was that "the book-to-tax differences are minimal" (O'Dell and Cohen, 1991:92) resulting in no need to provide for deferred tax. Revenue not taxable and expenses not deductible for tax purposes were reported in three possible ways in tax basis financial statements:

- as separate line items
- as adjustment(s) to net income

- in the notes.

Alderman (1982:54) also indicated that, although OCBOA is a fairly inclusive concept, it does exclude accounting practices prescribed in agreements (i.e. customised to meet the requirements of a specific contract).

In 1991, O'Dell and Cohen (1991:89) wrote: "As standards proliferate, OCBOA financials have become a viable alternative to GAAP for small business clients. Use by local practitioners is widespread and growing." In a survey of 2175 practitioners, 81% confirmed that they use OCBOA for "clients privately held" (O'Dell and Cohen (1991: 90). These financial statements provide reliable, timely (less dependant on outside parties, e.g. delays caused by auditors), but uncomplicated information, which is easier for the client to interpret.

O'Dell and Cohen (1991:89) also stated that disclosure requirements "are essentially the same for OCBOA and GAAP, but the OCBOA statements have simpler measurement requirements."

Stephen (2003: 2) also emphasized that "the cost savings associated with OCBOA statements primarily result from the ability to prepare financial statements using simpler measurement principles". Stephen also pointed out, however, that "practitioners should have an understanding of GAAP disclosure requirements to ensure that the OCBOA comply with the reporting requirements (for example, making disclosures that communicate the substance of GAAP disclosures)".

The auditor would, for an audit engagement, still be guided by generally accepted audit standards (GAAS) (Alderman 1982:58). The general guideline regarding disclosures in an OCBOA environment was that for "items that are the same or similar to, those in GAAP financial statements, the same type and extent of informative disclosure are generally appropriate" (Alderman, 1982:60). Furthermore, when different recognition

criteria are applied, it may transpire that an item is not recorded under OCBOA, while disclosure thereof may be appropriate.

Statements of changes in financial position are not a requirement for OCBOA statements, but are nevertheless often included by practitioners (Alderman, 1982: 58).

Eighteen years later, Martin (2000: 48) reported that OCBOA was still being used by most SME private companies in the USA, because accounting standards were focused mainly on public companies. In Canada the option to use the tax basis was approved in 2002 as part of their differential reporting concessions to owner-managed entities, providing that there was unanimous consent by shareholders and it was properly disclosed in the accounting policy note (Mersereau, 2002:32).

Clearly, the OCBOA model does not adhere to a model of “full compliance to GAAP less some disclosures”. Conversely, it does not hesitate to tamper with measurement and recognition criteria and the accruals principle, and seeks to prevent misunderstanding by means of additional disclosure. OCBOA is a method with good potential to achieve a balance between cost and benefit, hence aspects of this model could be considered for a third tier of financial reporting.

2.4.5 The audit implications of OCBOA

The Statement on Special Reports of the AICPA (AICPA, 1983: 400) stated that the auditor may express an opinion on financial statements prepared on OCBOA. In such a case the auditor’s report should include the following:

- Identification of the financial statements examined and a statement of whether generally accepted auditing principles were applied.
- The basis of presentation of the financial statements.
- A reference to the note in the financial statements describing how the basis of presentation differs from GAAP, without stating the monetary effect of such

differences. (If disclosure of the monetary effect is required, the cost saving achieved by the simpler method used may be lost again).

- A statement that the financial statements were not intended to be presented in conformity with GAAP.
- An opinion on whether the financial statements were prepared “fairly in conformity with the accounting basis described” (AICPA, 1983:402). The opinion paragraph of an audit report on a set of financial statements prepared on a cash basis, would read as follows: “In our opinion, the financial statements present fairly the assets and liabilities at 31 December xxxx and the revenue and expenses for the year ended on that date, on the basis of accounting described in note number xx.”
- A statement that the disclosed basis of accounting has been applied in a way consistent with the previous year.

The information listed above, however, is not seen as a qualification in the auditor’s report (Alderman, 1982: 62).

The auditor should consider whether financial statements prepared on OCBOA are appropriately titled. Titles like balance sheet and income statement were generally associated with GAAP statements. The title “Statement of assets and liabilities arising from cash transactions”, for example, may suit the cash basis better than “Balance sheet” (AICPA, 1983: 404).

Therefore it seems that an audit opinion can be expressed in an appropriate way, even though GAAP has not been adhered to strictly.

2.5 Differential reporting in South Africa

Section 286 of the SA Companies Act of 1973, required every company to present financial statements in compliance with generally accepted accounting practice. In 1999, SAICA issued Circular 8 to guide the interpretation of the phrase “in compliance

with generally accepted accounting practice” based on Counsel’s opinion. The interpretation was that, in order to prevent a qualified audit report, companies needed to comply with all statements of GAAP. In cases of non-compliance with any statement of GAAP, the details of the departure, the effect thereof and the reasons for the departure should be described, as prescribed in paragraph five of Schedule Four of the S A Companies Act of 1973.

In his article “The need for a Second Tier Accounting System” (Accountancy SA, May 2001) Hattingh claimed that over 90% of South African companies prepared financial statements for only one or more of the following three categories of users:

- South African Revenue Services (SARS)
- Bankers
- Shareholders (who are owner-managers)

All three of the above categories of users are in a position to demand financial information customized to their needs, and are not dependent on the financial statements of the company as the main source of financial information about the company. Paragraph 8 of The Framework for the Preparation and Presentation of Financial Statements (SAICA, 1990) indicated that the framework (and by implication GAAP accounting standards) was intended for companies with users who depended on financial statements as their major source of financial information about the company and as result of the variety of users, general purpose financial statements are applicable to such entities.

It could therefore be argued that general purpose financial statements should not be required for owner-managed companies with only users who are all in a position to obtain the information they require from sources other than the financial statements. Yet, at the time the SA Companies Act of 1973 was interpreted to have subjected all companies to the full vigour of GAAP, irrespective of size, users or nature. Therefore, with the growth in the number and complexity of accounting standards many companies came to experience accounting standards overload.

In May 2000, SAICA issued a discussion paper (DP 16) on Limited Purpose Financial Statements (SAICA, 2000). The paper did not set specific criteria to qualify entities for differential reporting. The general criterion stated was that in order to qualify, users of financial statements should be in a position to demand additional financial information according to their needs (SAICA, 2000). DP 16 did not waive any classification, recognition or measurement standards; it only trimmed disclosure requirements applicable to some GAAP statements and exempted other GAAP statements in totality.

Exposure Draft 163 (SAICA, 2003) titled “Framework for the Preparation and Presentation of Limited Purpose Financial Statements” was released in June 2003. This proposed statement of GAAP made a case for differential reporting for entities qualifying according to a user definition (like DP 16) and not according to any size criteria.

Limited purpose financial statements, according to ED 163, were justified if there were only a few users of the financial statements (e.g. SARS, shareholders and lenders). As a consequence of a decrease in the number and diversity of users, the information needs of users also decrease and:

- there is little need to do comparisons of financial statements among different enterprises, and
- the benefits from financial statements also decrease (SAICA, 2003: par. 12 – 18).

ED 163, though, identified only two tiers of financial reporting, applicable to a vast spectrum of qualifying companies, unlike the three tier proposal of the IWG.

Some of the comments on the exposure draft (SAICA 2003b), relevant to this study have been listed below:

- The inconsistent departure from measurement criteria in certain instances (for example, deferred tax) is problematic. The moment a measurement criterion is

not applied, “one has crossed a very significant threshold” and this calls for a fundamental rethinking which may lead to much more substantial changes.

“...once the users and their needs have been clarified, decisions in respect of recognition and measurement are made using that knowledge...”

(SAICA, 2003b: 4).

- The commentary around cash flow statements implied that these statements are meaningless and expensive, because they are not properly understood. The problem is the presentation in the form of “undoing accruals” in order to result in cash flow, instead of cash flow being the point of departure in the first place...”(SAICA 2003b: 7).

It is specifically noted that ED163 did not require a cash flow statement for limited purpose (tier 2) financial statements. The literature provides evidence about the perceived high value of statements of change in financial position and of cash-basis financial statements (Stanga and Tiller: 1983; O’Dell and Cohen: 1991). A possible explanation for the omission in ED 163 is that a cash flow statement was traditionally seen as a complex financial statement to prepare (especially if derived from the balance sheet and income statement using the indirect approach), defeating the cost-benefit criterion which, according to paragraph 44 of the conceptual framework (IASB, 2001), is a pervasive constraint on relevance and reliability in the financial statements.

A third tier of financial reporting could be very relevant in South Africa, because deregulation in the accounting arena would help to stimulate small business. If it is hypothesized that owner-managers of small businesses have a better understanding of cash-basis financial reporting than accrual-basis financial reporting, it may make sense that the cash basis should apply at the lowest tier of financial reporting as an important first step towards establishing a coherent framework for financial reporting, covering entities of all sizes and natures.

The IWG (United Nations, 2001: 6) pointed out that a tiered approach to financial reporting could be synchronized with a tiered system in the accounting profession.

According to the Close Corporation Act, No. 69 (1984: section 59 (1)), each close corporation must have an appointed accounting officer (SAICA, 2001: par. 92). A person qualifies to be appointed as an accounting officer if he/she is a member of a recognized profession (SAICA, 2001: par. 96). Section 58 (2) (b) of the Act states that GAAP, appropriate to the business of the corporation, should be applied to the financial statements (SAICA, 2001: par 68). Training of accounting officers may thus be aligned with differential reporting standards, since such accounting officers may find themselves only operating in a differential reporting environment.

In 2005 The South African Institute of Chartered Accountants (SAICA) adopted the international accounting standards set by the International Accounting Standards Board (IASB). As part of its larger convergence project, the IASB had embarked on a project to set accounting standards for small and medium-sized entities. Although the project title referred to SMEs, the overriding criterion for an entity to be classified as an SME for this purpose was lack of public accountability. No quantitative criteria were set to determine economic significance of an entity, but the IASB stated that the home country of the entity could add such criteria if wished to do so (IASB, 2006a:1). The responses to the 2004 discussion paper on accounting standards for SMEs showed a clear demand for IASB SME standards, resulting in the issue of an exposure draft of SME standards in February 2007 (IASB, 2008). The exposure draft, however, specifically focuses on financial reporting of those non-publicly accountable entities that have users other than primarily owner-managers (IASB, 2008:12) and by that, would defeat the major focus of this study, namely the needs of the owner-manager.

In 2006, section 1 of the Corporate Laws Amendment Act provided for a distinction between widely held companies and limited interest companies, the main criterion for the distinction between the two categories being based on the right to transfer shares without restrictions. The newly inserted section 285A of the Act required that limited interest companies should at least comply with the financial reporting standards developed for limited interest companies, and the provisions of the Act (including Schedule 4) applicable to limited interest companies. As mentioned above, the

International Accounting Standards Board issued an Exposure draft titled “IFRS for Small and Medium-sized Entities” in February 2007. The exposure draft was adopted later that year, without adjustment, by the Accounting Practices Board as a South African Accounting Standard, with the title “Statement of Generally Accepted Accounting Practice for Small and Medium-sized Entities for use by Limited Interest Companies (SAICA, 2007b).

The standards overload problem of many owner-managed entities, however, persisted, because the newly adopted GAAP statement (SAICA, 2007b: 12) stated in its scope that the targeted entities are SMEs that do not have public accountability that “publish general purpose financial statements for external users who are not involved in managing the business, existing and potential creditors and credit rating agencies” (SAICA, 2007b: 12).

In his article titled “IFRS for SMEs: Is small small enough?”, Coetzee (2007) pointed out the above problem of standard setters burdening owner-managed entities with the preparation of general purpose financial statements for a very small audience of users, at substantial cost, while the real information needs of those users are not considered. The appeal of the article is third tier financial reporting, with due consideration given to preparer focus as well as user needs of micro entities.

3 REVIEW OF THE LITERATURE: RESEARCH RELATING TO DIFFERENTIAL REPORTING

3.1 Introduction

The chapter deals with research testing the impact of differential reporting on users of financial statements, and research on the value of cash flow information. The thesis focuses on the needs of owner-managers of owner-managed entities and assesses the usefulness of a particular accounting basis, being cash or accrual, in an owner-managed setting.

The cash basis does not enjoy general acceptance and recent research has not been conducted on its merits. It is of key importance, however, to understand, that although statements of cash flow are traditionally derived from balance sheets and income statements, they can in principle be extracted from a cash-basis accounting system. Research on the value of statements of cash flow does, therefore, indirectly bear relevance to a debate regarding the potential usefulness of cash-basis accounting.

The work of researchers such as Lee and Eggington on cash-basis performance measurement has also been discussed in this chapter.

Furthermore a case is made in the chapter for reversing the traditional paradigm of deriving statements of cash flow as a by-product of accrual accounting, to one where a cash basis performance statement (as primary product of a cash-basis system) becomes the starting point, and accrual-basis financial statements become the by-product of the system.

3.2 Research testing the impact of differential reporting on users of financial statements

Several studies on differential reporting have assessed the impact of differential reporting on lenders in their capacity as users of financial statements (Caldron 1990; Stanga and Tiller 1983; Kent 1999). What are the lessons to be learned from such research, pertaining especially to tampering with measurement and recognition criteria as in the case of simple accrual-basis accounting and cash-basis accounting?

Caldron (1990) tested for evidence that enterprise size and ownership characteristics influence bank loan officers' information needs for a loan decision. The need for thirteen financial statement items was examined. Amongst the thirteen were control items (items that did not generate controversy in the standards overload debate) and key items (items, the need for which is perceived to be influenced by entity size and ownership characteristics) (Caldron, 1990:105). Other possible causes for variation in need for accounting information (e.g. decision context and user size) were held constant. Financial statements of two versions (large and small) of a hypothetical manufacturing company were designed. Respondents were to evaluate the extent to which the evaluation of the loan would be affected by each of the thirteen items.

The results, on the one hand, supported the notion that the need for the control items does not depend on size and ownership characteristics, but on the other hand, there was no clear evidence that the key items were more needed for large company loan decisions than for small company loan decisions (Caldron, 1990:113). This study, therefore, did not show justification for differential reporting.

Stanga and Tiller (1983) used two versions of a pre-tested questionnaire to gather information for a study, capturing the perceptions of 400 American bank loan officers on the importance of forty specific items of accounting information. The importance of each of the forty items was rated on a five-point scale. The two versions of the questionnaires differed in so far as they reflected a large public company context with

revenues of at least 125 million dollars versus a small private company context with revenues of not more than 5 million dollars. The two groups generally agreed about the degree of importance of most questionnaire items (Stanga and Tiller, 1983: 68). Interestingly, the results revealed high importance for the statement of changes in financial position, segment information was rated as very important for both large and small companies, while capitalization of leases showed as only moderately important in the small company context. Constant dollar and current cost information (ten items on the questionnaire) ranked only moderately important even in the large company context. The results of this study may be construed as lending limited support to the view that GAAP should be simplified for all business enterprises rather than basing simplification on size and ownership considerations (Stanga and Tiller, 1983: 68). It is specifically noted that the statement of change in financial position (typically a statement of cash flow) scored high in the small company context.

An Australian researcher (Kent, 1999) tested the effect of differential reporting on loan evaluations by subjecting financial statements of a small company to the scrutiny of various loan officials: the financial statements, though, were prepared in two ways. The one set of financial statements was in full compliance with GAAP, while, in the other set, the following GAAP standards were ignored:

- accounting for leases (leases not capitalized)
- accounting for income tax (no deferred tax provided)
- statement of source and application of funds (not prepared)
- accounting for goodwill (goodwill not amortized).

Kent's findings were as follows (Kent, 1999:13):

- GAAP and non-GAAP financial reports are equally useful in assessing ability to repay a loan.
- The loan officers (as a group) made 35 adjustments to the GAAP financial statements, and 42 to the non-GAAP financial statements, in the process of assessing the financial statements. This suggests that neither GAAP, nor non-

GAAP financial statements, really provided the loan officers with the information in the preferred form.

These findings seem to lend some support to simple accrual-basis accounting for smaller entities in line with the tier 3 proposal of the IWG, because it implies that the effort needed to assess the ability to repay a loan is considerable, regardless of the more sophisticated application of accrual accounting via GAAP.

Leftwich (1983) (not in a small company context) compared the measurement rules negotiated in a sample of private lending agreements, with the measurement rules allowed by GAAP (in the USA). He found that for seven of twenty nine categories tested, the negotiated method was completely outside GAAP (Leftwich, 1983: 37). A few specific (negotiated) measurement rules deserve mention:

- Fixed assets – only depreciated historical cost; not net replacement value.
- Liabilities – defined more broadly than GAAP; contingencies arising from contracts typically treated as liabilities (Leftwich, 1983: 33).

This study seems to support Kent's (1999: 13) finding that "strict GAAP financial statements" are not superior to non-GAAP financial statements with regard to relevance to users of financial statements of smaller entities.

Some other research projects (Page, 1984; Holmes, Kent and Downey, 1991; Stainbank and Wells, 2005; Van Wyk, 2005; Stainbank and Wells, 2007; Maingot and Zeghal, 2006) have specifically touched on the issue of basis of accounting, being cash or accrual, and the owner-manager as user of financial statements.

Page (1984) surveyed directors of private companies in the UK. A sample of 1000 companies was randomly selected from the Register of Companies, of which 413 were found to be active and independent from holding companies. A 41% response rate was achieved from the directors of the targeted companies (Page, 1984: 274). For a

company as form of enterprise, the majority of respondents saw limited liability as the main advantage and “government form filling” as the main disadvantage. Management, banks and tax authorities were perceived to be the main users, while the most important use of financial statements for directors was assessment of profitability (Page, 1984: 275). The three most important services provided by accountants were indicated as tax services, preparation of accounts, and the audit itself (Page, 1984: 276). A bare majority of directors wanted less disclosure. While the study implied that directors did not find disclosure requirements a substantial burden, this can be understood in the context of the accountant absorbing the problem. This view is confirmed by Kent (1999:13), who noted in his research that accounting practitioners are, understandably, the strongest advocates of differential reporting. Barrer and Wood (2002: 213) used a technique, data envelopment analysis (DEA), to demonstrate, in the Italian context, that accounting service providers provide a more efficient platform for small firm accounting than in-house provision. It is to be expected, therefore, that accounting practitioners would advocate strongly for differential reporting and that the accountants would be a valuable source regarding the needs of the owner-managers of smaller entities.

Holmes, Kent and Downey (1991) conducted a survey of the perceived need for differential reporting in Australia. Their questionnaire involved six hypothetical entities, varied by size and legal structure. A sample of 273 practising chartered accountants in Australia was randomly selected from a membership list of the Institute of Chartered Accountants in Australia. The results indicated that the level of applicability of accounting standards to public companies and for sole traders (of the same size) respectively, was not perceived to be significantly different. However, the two differently sized private companies attracted significantly different responses on applicability of accounting standards (Holmes, Kent and Downey, 1991: 128). Respondents also indicated that the majority used the income tax basis for privately owned companies (Holmes, Kent and Downey, 1991:129). The only accounting standards perceived to be relevant for small private companies were Australian Accounting Standard 1 (AAS 1), on the profit and loss statement, AAS 2, on inventories, AAS 4, on depreciation, and AAS 5 on materiality. The majority of

respondents indicated that, although relating to all entities, AAS 3 on taxes, AAS 17 on leases and AAS 21 on acquisition of assets, were not relevant to small entities (Holmes, Kent and Downey, 191:130). These findings also seem to lend some support to simple accrual-basis accounting for smaller entities, because standards perceived by respondents not to be relevant for small private companies (e.g. on leases and taxes), are associated with more sophisticated accrual accounting (e.g. capitalising finance leases and providing for deferred tax).

Stainbank and Wells (2005) surveyed the perceptions of South African Registered Accountants and Auditors regarding the most suitable form of differential reporting, ranging between the cash basis as most simple form, to a completely separate set of SA GAAP, considering both a narrow and wide user base context. They found no significant support for the cash basis, while there was some support for the tax basis in the narrow user basis context. Stainbank and Wells (2005: 63), however, acknowledged that more detailed research might find the cash basis relevant for the smallest of corporate entities.

Van Wyk's (2005: 11 - 16) research amongst owner-managers, professional accountants, SARS and local banks in the Free State Province, confirmed the Stainbank and Wells finding that there is little support for the cash basis, while the study re-iterated annual financial statements to be a valued source for decision-making for owner-managers.

In 2007, Stainbank and Wells published research results of a survey requesting South African Registered Accountants and Auditors to indicate their differential reporting preferences for twelve hypothetical entities varied by size, legal form and user base. The results showed that a single differential reporting tier would not be appropriate for the South African financial reporting landscape. Two of the twelve categories were private companies and close corporations, both with a turnover of maximum R600 000 and only owner-managers and SARS as users. The study specifically showed that statements of cash flow were not appropriate for such entities (considering both size

and narrow user base). It was also found that differential reporting should not only focus on relief from presentation and disclosure requirements, but also from recognition and measurement requirements.

Maingot and Zeghal (2006) surveyed perceptions of Canadian practising accountants and found that owner-managers of so-called small business enterprises (SBEs) used financial statements for tax purposes, the bank and management purposes. They found, like Page (1984) that owner-managers use financial statements mainly for review of financial performance, while their respondents also pointed out management planning as a secondary use of financial statements.

Clemens and Dyer (1979: 275) argued that the character and capability of a firm are judged by much wider observation than just the financial statements. The question does arise, therefore, whether owner-managers of SMEs are perhaps using other (more powerful) performance indicators than financial statements.

Jarvis (2003: 80) made the interesting observation that the owner-managers of smaller entities have to rely on the annual financial statements for financial planning, control and other financial decision-making, unlike bigger entities which may use more sophisticated management accounting systems for this purpose.

The research project on micro entities commissioned by the International Federation of Accountants (IFAC 2006 and 2008), provided a solid foundation for further research into a suitable third tier of differential reporting. A focus group approach was used involving preparers of financial statements, owners and lenders. Some of the principal findings were as follows (IFAC, 2008:7-10):

- The focus regarding a micro entity definition should best be on owner connectivity to the entity and an assessment of the need for external information and creditor protection.
- Generally, financial statements are prepared on the accrual basis.

- There is a need for some form of attesting of financial statements, preferably by an accountant.
- Lenders find balance sheets, income statements and statements of cash flow useful and they would value some form of attesting of financial statements.
- Owners rely heavily on the accountant to inform the form of financial statements and often prefer fixed formats for financial statements.
- Financial statements should be simple and the envisaged third tier accounting standard should be very brief and principle based.
- A third tier standard should be crafted by a “bottom-up” approach. This observation appeared to reflect the spirit of the IWG’s third tier model proposed in 2001 which suggested adherence to basic accounting principles and rethinking presentation of financial statements to be conducive to the needs of its users.

Some of the specific comments by focus groups deserve mentioning, because they effectively emphasise some of the sentiments expressed in this study:

- Regarding entity definition: “...don’t want investor protection because you’ve got no investors...” (IFAC, 2008:25).
- Regarding a bottom-up approach: “...important that whatever changes come in are widely discussed within the business community and not within the accounting community...” (IFAC, 2008: 25).
- Regarding simplicity: “...simple income statement where we can get it as close as possible to a cash base kind of system...” (IFAC, 2008: 26) and “...simplicity is the thing that drives...” (IFAC, 2008: 31).
- Regarding a principle based instead of rules based approach: “...if you have a good principle based standard I can’t think why you want to update it at all...” (IFAC, 2008: 29).

One of the Kenyan focus groups concluded that, although financial statements are often prepared for external use, in time “it helps you to know where you are coming from and it’s really helpful to see the future.”(IFAC, 2008:47). The IFAC research

has emphasized that the accounting profession has to demonstrate the creativity to balance the quest for simplicity to maximize cost-benefit for micro entities, while an appropriate level of protection is ensured for external stakeholders in their dealings with a micro entity.

The main aspects of the above research on differential reporting are summarised in the table that follows:

Table 3.1: Prominent research done on the impact of differential reporting on users of financial statements.

Author(s)	Caldron	Stanga and Tiller	Kent	Page	Holmes, Kent and Downey
Year published	1990	1983	1999	1984	1991
Location	USA	USA	Australia	UK	Australia
Research instrument	Financial statements for each of two versions of a hypothetical company (differentiated by size)	Two versions of an otherwise identical questionnaire, differentiated only to reflect a large vs small company context	Two versions of the financial statements of a small company. One in full compliance with GAAP; the other in contravention of certain GAAP standards	Questionnaire	Questionnaire involving six hypothetical entities, varied by size and legal structure; sole trader, private company and public company
Research subjects	Bank loan officers	Bank loan officers	Bank loan officers	Directors of private companies	Practising members of the Institute of Chartered Accountants in Australia
Sample	750 banks in 49 states selected from Polk's World Bank Directory (1985 edition)	A sample of 200 loan officers from the larger bank sector and another 200 from the smaller bank sector	46 loan officers from four major Australian bank groups participated in laboratory conditions	413 (active and independent) companies randomly selected from the Register of Companies	273 practising accountants randomly selected from a membership list
Response rate	21%	N/A	N/A	41%	33%

Author(s)	Caldron	Stanga and Tiller	Kent	Page	Holmes, Kent and Downey
Most important findings	<p>The type of information needed to base a loan decision on, is basically the same for both large and small entities</p> <p>Results fail to support the hypothesis that the need for financial statement items is associated with the size and ownership characteristics of a reporting entity</p>	<p>GAAP as a whole should rather be simplified than to base differential reporting on size and/or ownership characteristics</p> <p>Importance of statement of changes in financial position ranked high for both small and large firms</p>	<p>GAAP and non-GAAP financial statements may be equally useful as assessment instruments for a loan decision</p>	<p>Owner-managers, banks and tax authorities are the main users of annual financial statements (AFS)</p> <p>Assessment of profitability is the most important use of financial statements</p> <p>AFS highly ranked as source of management information; ranked higher than use for tax purposes or its use by banks</p>	<p>Perceived need for differential reporting, for differently sized enterprises, proved to be much more prominent for small private companies than for other forms of enterprise</p> <p>The tax basis widely in use for private companies</p>
Relevance to this study	<p>Study does not support differential reporting</p>	<p>Study shows justification for simple accruals basis accounting for all entities</p>	<p>Study shows justification for simple accruals basis accounting for smaller entities</p>	<p>Study shows financial statements are a very important source of management information for owner-managers</p>	<p>Study shows justification for simple accruals basis accounting for smaller entities</p>

Table 3.1 Prominent research done on the impact of differential reporting on users of financial statements (continued)

Author(s)	Stainbank and Wells	Van Wyk	Stainbank and Wells	Maingot and Zeghal	IFAC
Year published	2005	2005	2007	2006	2008
Location	South Africa	South Africa	South Africa	Canada	England, Kenya, Poland, Italy and Uruguay
Research instrument	Questionnaire	Questionnaire	Questionnaire	Questionnaire	Focus groups
Research subjects	Registered Accountants and Auditors	Professional Accountants, members of close corporations, bankers and SARS	Registered Accountants and Auditors	Chartered Accountants and Certified General Accountants	Owners of micro enterprises, lenders and preparers of AFS
Sample	353 Registered Accountants and Auditors randomly selected from the Public Accountants' and Auditors Board's list of members	299 questionnaires, distributed to mainly accountants, but also to other user groups	353 Registered Accountants and Auditors randomly selected from the Public Accountants' and Auditors Board's list of members	600 Chartered Accountants and Certified General Accountants randomly selected from membership lists	Six to eight delegates per focus group recruited by accounting institutes
Response rate	18%	18%	18%	27%	N/A
Most important findings	The cash basis and unlimited deviations from GAAP were rated unsuitable irrespective of width of user base and practice size of respondents	Owners, SARS and banks confirmed as main users, while management decision-making ranked the third most important use for financial statements (after the tax and bank purpose)	Cash flow statements are not appropriate for small private companies and close corporations with only owner-managers and SARS as users	The main external purposes of SME (SBE in Canada) financial statements was confirmed to be tax purpose and bank purpose, while for purposes of owner-management, review of performance and planning ranked the highest	AFS were typically accruals based and cash flow statements were not found useful by owners If any third tier accounting standard, it should be very short, simple and principle based

Author(s)	Stainbank and Wells	Van Wyk	Stainbank and Wells	Maingot and Zeghal	IFAC
Most important findings (continued)	Some support was found for the income tax base for a narrow user base context.	<p>Some close corporations do not use the AFS at all. SARS and banks find the AFS the main source of information but often request additional information as well.</p> <p>The majority of the respondents rated the tax basis as the most appropriate basis, while the cash basis was the least sought after basis.</p> <p>The accountants rated the full GAAP approach the lowest of presentation methods.</p>	<p>Size, entity form and user base are collectively more significant in determining differential reporting thresholds / tiers than any single factor</p> <p>Differential reporting concessions for recognition and measurement requirements as relevant as presentation and disclosure concessions</p>	<p>The advantages most expected from differential reporting standards were simplicity and cost reduction, while delay reduction and increased relevance to business ranked third and fourth in importance</p>	<p>There is a need for a simple form of attestation of AFS, preferably by an accountant</p> <p>Accountants are key players in enhancing the financial literacy of owner-managers and the profession should therefore be creative in giving guidance regarding user friendliness of financial statements</p>
Relevance to this study	Study shows justification for simple accruals basis accounting for smaller entities and acknowledges that the cash basis may well be applicable to very small entities	The owner-managers of close corporations and other SMEs are dependent on AFS as source of financial information and they do not prefer a cash basis of accounting	Small owner-managed entities do deserve a separate tier of differential reporting. Cash flow statements should not be required for such entities	<p>Review of performance by Owner-management and planning are perceived to be important purposes of financial statements</p> <p>The quest for simplicity as the most sought after virtue of financial statements for small business is also significant for this study.</p>	<p>Cash flow statements are not appreciated by owner-managers</p> <p>A third tier accounting standard must consider the micro entity environment</p> <p>Simplicity and cost-benefit should be key drivers in the creation of a third tier accounting standard</p>

3.2.1 Aspects from the user research relevant to the research question

On consideration of the different contributions of the research on differential reporting, the following points stand out:

- Owner-managers are acknowledged as important users of financial statements (Page, 1984; Van Wyk, 2005; Stainbank and Wells, 2007).
- Lenders often apply their own measurement and recognition criteria to elements of financial statements (Leftwich, 1983; Kent, 1999).
- Lenders do find statements of cash flow useful (Stanga and Tiller, 1983; IFAC, 2008).
- Owner-managers do not find statements of cash flow useful (Stainbank and Wells, 2007; IFAC, 2008).
- The relative importance of annual financial statements to other performance indicators and drivers of decision-making for owner-managers is not addressed in the above research. Jarvis (2003) found, for example, that the more sophisticated the management accounting systems in place, the less an entity has to rely on annual financial statements for planning and control.
- Owner-managers value profitability measurement as an important use of financial statements (Page, 1984; Maingot and Zeghal, 2006).
- There is considerable support for a simple accrual basis to be applied in owner-managed entities (Holmes, Kent and Downey, 1991; Stainbank and Wells, 2005; Van Wyk, 2005).
- There is not considerable support for a pure cash basis to be applied in owner-managed entities (Van Wyk, 2005; Stainbank and Wells, 2005).

3.3 Research on the value of cash flow information

Much research has been done on the value of statements of cash flow in the corporate environment. A cash flow statement as part of accrual-basis financial statements has the

effect that the accrual basis is ignored and therefore such a statement gives information similar to what a report extracted from a cash basis accounting system can give. As result of this link between cash flow statements and cash-basis accounting, cash flow statements are covered in the review of cash-basis literature.

The focus in this part of the literature review is on those aspects which may have relevance for owner-managed SMEs in particular.

Collins and Jarvis (2002: 101) found that SMEs pursue strategies very different from those of large firms. SMEs place value on autonomy, survival and stability, unlike large firms which tend to pursue financial growth. If many SMES indeed find themselves in constant survival mode where liquidity and solvency management is critical, financial reporting emphasizing the cash aspects of an entity may be very relevant to such entities.

3.3.1 Why an interest in cash flow reporting?

The accelerating international trend towards cash-flow reporting had been fueled by many corporate collapses and worldwide economic recessions (Jones & Widjaja, 1998: 204). Why, though, did income statements and balance sheets fail to give the necessary warning signals to the collapsed companies at the time? Charitou & Venieris (1990) studied the financial statements of two Greek bankrupt firms for the ten years preceding their bankruptcy. They found that in both cases earnings and working capital were positive in all ten years (except the last) while cash flow from operations was negative during all the years (Charitou & Venieris, 1990: 115). The above-mentioned Greek examples also explain why fund statements, with funds defined as net working capital, were replaced by cash flow statements, with funds defined as only cash and cash equivalents. The time lag from buying inventory until the eventual collection of receivables was veiled by both income statements and working capital based fund statements. Proper cash flow analysis therefore could have provided earlier warning signals of problems to the companies under review.

Chartou and Ketz (1991: 54) identified some reasons, other than working capital related, why earnings and cash flow from operations, at the time, had drifted apart since the sixties:

- Non-operating items in earnings (e.g. a gain from disposal of property, plant and equipment).
- Current value accounting (e.g. the non-cash cost of sales adjustment).
- More debt in the capital structure (if interest is classified as a financing activity).

Notably at present, international accounting standards provide for property, plant and equipment, investment property, intangible assets and financial instruments to be carried at fair value, resulting in fair value based depreciation, gains and losses, enhancing the “drifting apart” effect identified by Chartou and Ketz. Furthermore, it is noted that IAS 7 (IASB, 2009: paragraph 33) does permit a choice between disclosing dividends and interest paid as either an operating activity or a finance activity.

3.3.2 Using financial statements together

Epstein & Pava (1992) surveyed 246 investors in listed companies to obtain their perceptions of the usefulness of statements of cash flow. The respondents regarded the cash flow statement almost as useful for making investment decisions as the income statement and balance sheet, although, at the time, cash flow statements were a recent development in the USA (Epstein & Pava, 1992:5).

In their survey amongst 159 financial statement users (loan officers and financial analysts), Jones & Widjaja (1998: 213) found that the great majority of respondents used the cash flow statement in conjunction with the balance sheet and income statement for decision-making. The study concluded that the cash flow statement can be regarded as a general purpose (primary) financial statement, “having the capacity to meet the information needs of a range of users and across a large number of decision

contexts, including liquidity and solvency factors, predicting contexts, monitoring tasks and performance evaluation.”

Ingram & Lee (1997: 168) stated: “A theoretical analysis of the accounting measurement process indicates that the information provided by accrual and cash-based measures depends on their joint relation rather than on either measure alone or on their incremental contributions.”

A statement of cash flow, clearly, must not be used in isolation.

3.3.3 *The importance of the distinction between operating, investing and financing activities*

Greenberg et al (1986) determined current earnings as the superior predictor of future cash flow above current cash flow from operations, but used only indirectly determined cash flow from operations (not paying attention to investing activities).

Casey and Bartczak (1985: 395) used only cash flow from operations and concluded that these do not provide incremental predictive power over accruals information in predicting bankruptcy. Aziz and Lawson (1989) found that the predictive power of cash flow information as an early warning signal for bankruptcy was underrated by some previous researchers, because they only paid attention to cash flow from operations. In their model, Aziz and Lawson (1988: 56) not only took investment activities, but also financing activities, into account.

Arnold et al (1991) argued that much of the research done on the effect of cash measures as opposed to earnings figures on share prices in capital markets (e.g. Greenberg et al, 1986 & Casey and Bartczak, 1985) made a conceptual error by using cash flows from operations or working capital from operations, instead of entity cash flows (i.e. the net cash result of both operating activities and investing activities). They argued (Arnold et al: 18) that there is a logical linkage between entity cash flows and standard valuation models (value based on the present value of future entity cash flows) which is often ignored in the literature. They performed correlation tests from a data set

of 171 UK listed companies over a 20 year period. It was found that neither earnings, nor cash flows from operations, effectively captured the signal provided by entity cash flows (Arnold et al, 1991: 17).

Loftus and Miller (2000: 48) state the following: “Over the life of a business, accounting net income equals cash flows from all sources, except borrowings and repayment of debts and transactions with owners. In other words, lifetime income equals cash flows from operations and investment activities (it is entity cash flows), the cash flows the business generates for itself (not from owners and lenders).” Earnings, thus, is an estimate of the long-run (average) cash generating ability of the current earnings process. Since the earnings figure does not reflect intermediate fluctuations in cash position and liquidity, specific decisions on interest, dividend, or principal payment must be informed by cash flow analysis.

Annexure 6 portrays a small hypothetical entity that commenced operations in 2006 and liquidated in 2009 to illustrate that conceptually “life earnings” of an entity equals its cash generated from operations net of investment activities (entity cash flows), excluding distributions to owners.

Bowen, Burgstahler & Daley (1987: 746) demonstrated that cash flow after investment activities indeed had incremental information content after allowing for the association between security returns and earnings.

What then, is the relevance of the above discussion on entity cash flows? Ironically an accrual-basis accounting system is not needed to calculate entity cash flows. Clearly the allocation of cash inflows and outflows amongst operating, investing and finance activities can be accomplished within the confines of a cash-basis accounting system and hence a financial report stating entity cash flows can be extracted from such a cash-basis system. This phenomenon is explained in the next section.

3.3.4 Accrual-basis information versus cash- basis information for the preparation of statements of cash flow.

Statements of cash flow can be prepared from accrual-basis balance sheets and income statements, without drilling down to detailed accounting records. As long ago as 1985, however, Dritina & Largey (1985:325) warned that cash flow from operations merely derived from accrual-basis profit, may lead to an inaccurate presentation of the cash effect of operating, finance and investment activities, because the use of aggregate balance sheet figures such as debtors and creditors can veil details relevant to an accurate classification exercise.

Bahnson, Miller & Budge (1996: 12) recommended that accounting systems be refined to produce accurate cash flow reports using actual movements in the bank account as basis, instead of cash flow statements merely being derived from balance sheets and income statements. Practically, the suggested refinement entailed changing the ledger as follows:

- The bank account opening balance is kept on a real (balance sheet) account.
- Cash movements for the reporting period are captured in a separate nominal ledger with accounts for each item to be found in a statement of cash flow, such as receipts from customers and proceeds from disposal of plant (Bahnson, Miller & Budge (1996: 12).
- The bank balance will be calculated by closing this nominal ledger to the real bank account, i.e. the bank account is built up from temporary accounts for individual receipt and payment types, closed against a permanent asset or liability account to arrive at a closing balance.

In Annexure 7 the transactions for a hypothetical small entity are captured on both an accrual basis and a cash basis. It will be noted that both basis provide the information necessary to generate a statement of cash flow.

3.3.5 Direct versus indirect statements of cash flow

The format of an indirect statement of cash flow emphasizes the reconciliation between accrual-based profit and cash flow from operations, while the format of a direct cash flow statement shows the composition of cash flow from operations, comprising of gross cash received from customers, minus cash paid to suppliers and employees.

The survey conducted by Jones and Ratnatunga (1997: 79) amongst Australian preparers of financial statements highlighted the following points in favour of the direct method:

- enhances user understanding (accepted commercial practice reflects receipts less payments)
- enhances cash flow analysis
- better indicator of solvency (in the context of ability to pay obligations as they become due)

On the downside the study pointed out that the direct method is more complex and that changes in components of working capital are not emphasized by this method.

If user understanding is enhanced by cash flow information in the corporate environment, it could be hypothesized that this would be even more so in the micro entity environment where organizations may not possess the skills to understand non-cash information.

Using a direct method of presenting cash flows, though, does not need to be incompatible with emphasizing change in working capital components, at least not in a simple business setting. Broome (2004) made a clear case for taking advantage of the strengths of both the direct and indirect methods by using the clear logic of the direct method, but doing a reversed reconciliation between cash flows from operations and net income. Such a reversed reconciliation may be more user-friendly because items like

depreciation and prepaid expenses are treated mathematically the same as in the income statement (Broome, 2004:20). In this system, adjustments to convert cash flows from operations to net income can be divided into the following classes:

- Cash inflows not recognized as revenue in the current year's income statement (eg. decrease in accounts receivable).
- Revenue in income statement not represented by cash inflows (e.g. increase in accounts receivable).
- Cash outflows not recognized as expenses in the current year's income statement (eg. decrease in accounts payable).
- Expenses in the income statement for which there are no current cash outflows (eg. depreciation).

The idea that a cash basis in principle, enhances the preparation of a direct statement of cash flow and that the cash statement can precede an accrual-basis statement by reconciling a cash surplus into an accruals based profit is particularly evident in this section.

3.3.6 The perceived value of statements of cash flow

Jones & Ratnatunga (1997: 70) reported that bankers and managers used statements of cash flow for many financial decisions. The following decision contexts of statements of cash flow were regarded as significant by the respondents tested by Jones et al (1997: 73):

- ability to pay dividends
- assessing quality of net income
- liquidity evaluation
- evaluating managerial performance
- evaluating overall company performance
- evaluating operating performance
- highlighting cash and non-cash aspects of financing and investment activities
- comparing performance with other companies

- predicting future cash flows
- monitoring fixed asset investments.

3.3.7 *The merits of converting cash flows from operations into an accrual-basis profit figure (instead of vice versa)*

Traditionally accrual-basis profits have been converted to cash flows from operations figures via the indirect method. The notion of giving a detailed cash-basis “income statement” as point of departure and then converting it into an accrual-basis profit figure has been implied by Broome (2004). Interestingly, more than one researcher preferred to explain the theory of earnings by using this method.

Bernard and Stober (1989: 625) analyzed earnings as comprising three components: cash flows from operations, current accruals (i.e. changes in working capital) and non-current accruals (e.g. depreciation). They observed that the cash component can be seen as the best quality component, while current accruals are of lesser quality and non-current accruals of least quality.

Cotter (1996) also analyzed earnings as comprising the components as identified by Bernard and Stober, but added a fourth component, namely non-operating accruals (e.g. holding gains of investments) (Cotter, 1996: 134). Cotter further observed that non-current accruals are a “slower signal” of investment activity than cash flows from investment activities, arguing that, over the short term, signals with value implications are picked up faster by cash flow information than by accruals-based earnings.

3.3.8 *Cash basis performance measurement*

Lee (1981a) linked traditional cash flow statements with net realizable value statements. In a net realizable value accounting system, all assets are valued in net realizable value terms, because it is not assumed that an entity is a going concern and the focus is on entity survival (1981a: 164). In a net realizable value system, a balance sheet becomes a statement of cash resources, and claims against the cash resources. In

this approach equity becomes “indefinite obligations”, liabilities are still divided into long and short term, while assets are divided into realized assets (including cash and cash equivalents), readily realizable assets, and non-realizable assets, the last category listed on the balance sheet (statement of cash resources), but not valued in monetary terms at all. This system holds the advantage of being relatively allocation-free and provides information to be fed into decision-making models e.g. shareholders’ dividend decision and lenders’ decisions about interest and principal repayments. A particular point of merit in the Lee model is the clear distinction between objectively measured realized cash flow data on the one hand, and subjectively measured potential cash flow data described by unrealized movements in the enterprise’s assets and liabilities on the other hand (Lee, 1981a:169). Lee achieved this by distinguishing factual from judgmental data, thus assisting the user to assess the varying degrees of credibility inherent in such information.

In Annexure 5, a small hypothetical entity was used to illustrate the difference between conventional accrual-basis financial statements and financial statements according to the Lee model. For the sake of easier comparison, the asset values in the conventional financial statements were already stated at net realizable value. It should be particularly noted that in the Lee model, the primary activity of the model is to determine equity (so-called indefinite obligations) at net realizable value, while profit measurement is a secondary activity, determined by the change in equity (indefinite obligations) between two reporting dates, taking into account transactions with owners. In the hypothetical example, the change in indefinite obligations of R8, R5 and R24 respectively was adjusted for transactions with owners (members’ contributions and distributions) to have revealed profit figures of R48, R40 and R29 respectively. It is clear from the annexure, that a conventional accrual system, where assets and liabilities were carried at net realizable value, would have produced identical profit figures (being R48, R40 and R29). Measurements associated with going concerns, such as fair value and value in use, are not taken into account in net realizable value profit measurements.

If owner-managers are indeed in survival mode and cash orientated, they might perhaps gain by being educated gradually to use accrual-basis information to supplement actual cash information because, in Lee's thinking, cash resources are factual regarding their potential to settle obligations, whilst non-cash assets are potential resources, enabling a longer term view of the enterprise. An entity starting off small may initially only need a simple accrual-basis system and may later evolve to develop the need to more accurately predict future cash flows, justifying a more sophisticated accrual-basis system. Hence, cash-basis financial statements designed in a way to ensure a logical progression into an accrual-basis system, may be very relevant for an owner-managed entity.

Egginton (1984) raised arguments to point out the inadequacy of statements of cash flow for performance measurement purposes. He argued that cash flow analysis does show sources and uses of cash. His concern is extending this ex-post position to mean that past cash flows can reveal future cash generating ability regarding obligations, distributions and continuity. Cash flow analysis veils certain downside risks (e.g. the financial risk of dependence on trade credit) but also "gives sparse indication of the upside 'potential' of certain externally financed assets" (Egginton, 1984: 104). Furthermore, opening and closing position statements are clearly a pre-requisite for proper performance measurement to see if the entity has augmented or depleted resources (Egginton, 1984: 102).

Lee's (1981) claim that cash flow analysis sidesteps allocation, is countered by Egginton, especially on the issue of so-called "classification allocation" (cash flow information still has to be allocated under certain headings) (Egginton, 1984: 101). The argument that skewness fabricated by a cash-based time allocation (as in cash flow statements) as opposed to a resource generation and consumption based time allocation (as in accrual accounting) can be countered by a longer term view, ignores the importance of timeliness in accounting (Egginton, 1984: 103).

Egginton (1984: 107) does agree, though, that the Lee model may be very useful in a liquidation context. If it is argued that an entity in survival mode almost always faces a potential cash flow problem, it again points towards high relevance of cash-basis accounting for many small enterprises.

It appears therefore, that the question of suitability of a particular accounting basis does indeed depend on the time horizon adopted by the owner-managers, which, in the case of entities such as micro entities in survival mode, would be a very short term. In such a case, cash-basis performance measurement may be adequate, which implies that the cash basis or the simple accruals basis may be suitable. In terms of the Lee model (Lee, 1981a:169) this would still result in accurate factual data (realized cash flows), while the judgmental data (potential cash flows) will be less accurate.

A simple accruals basis implies that accruals will only be reflected in the financial statements to the extent that the cost to obtain the information is outweighed by the usefulness to the users of the financial statements. Obvious items for inclusion are trade receivables and payables and inventory, while less obvious items for inclusion would be capitalised leased assets and liabilities and deferred tax. The thinking is that the calculation of entity cash flows is simple in principle, while every piece of accruals information added (judgmental data) is of less quality; hence a simple accruals system implies the cost efficient addition of accruals information to cash-basis information.

3.3.9 Aspects from the cash flow literature relevant to the research problem

If one considers the different contributions from the research on cash flow, the following points appear relevant to the research question (as stated in the next chapter):

- Cash flow information is vital for users of financial statements to assess whether the solvency and liquidity of the entity is sufficient for survival (Charitou & Venieris, 1990).

- To predict future cash flows and to apply a present value model for valuation purposes, amounts and timing of cash flows is important. In this regard, cash and accrual information need to be used together, not in isolation (Jones and Widjaja, 1998). Future cash flows cannot be projected from historical cash flow statements alone; accrual accounting information is vital to refine such cash flow projections (e.g. debtors collection period enables one to convert projected sales into projected receipts from customers), however, since accrual information is judgmental in nature, the amount of sophistication of such information should be subject to strict cost-benefit testing.
- Over the long term, earnings equal entity cash flows (Loftus and Miller (2000)). Conceptually the differences between accrual-basis profit and entity cash flows in any particular reporting period result from changes in the carrying amounts of assets other than cash, and current liabilities. This implies that in a case where the asset base of an entity is small, there may be little difference between accrual-basis profits and entity cash flows, and the use of the cash basis or simple accrual basis may be justified.
- Format is critical for the decision-making usefulness of statements of cash flow (Klammer and Reed, 1990).
- If the accounting system is set up correctly, it is easy to produce direct cash flow statements (Bahnsen, Miller and Budge, 1984) and by implication, a direct cash flow statement can be prepared from cash-basis information.

3.3.10 Conclusions

Statements of cash flow report on only one resource, being cash. They show cash generated and utilized in a particular reporting period. Cash generated from operating activities, on the one hand, provides the user with information about the best quality component of profit, but, on the other hand, it does not flag the other three components of profit, being current accruals (for example an increase in trade receivables),

non-current accruals (for example depreciation) and non-operating accruals (for example fair value gains on investment property).

Net realizable value statements, prepared according to the Lee approach, report on the net realizable value of all resources, emphasizing cash as well the convertibility of other assets into cash. This approach therefore serves a relatively short-term time horizon, emphasizing survival of the entity, while the going concern assumption is not made.

A simple accrual-basis system reports on cash as resource as well as some other resources, typically measured on a historical cost basis. Profit measurement will therefore include cash, but also current accruals and non-current accruals, selected on the basis of an assessment of cost-benefit. Since historical cost is the typical measurement base, non-operating accruals (for example fair value gains) will not often be found in simple accrual-basis accounting.

In an owner-managed entity the time horizon for financial decision-making may be relatively short and the going concern assumption may be questionable. Furthermore the asset base of a specific entity may be small relative to its activities, implying that the impact of the three accrual components of profit may be of less significance.

This chapter of the literature study sought to put forward some normative arguments as to the relative usefulness of cash-basis versus accrual-basis information for owner-managed entities. The primary focus in the study is not on entity size. Researchers did not find convincing evidence that entity size justified differential reporting (Stanga and Tiller, 1983; Leftwich, 1983; Kent 1999).

In the next chapter it is explained how the financial information needs of owner-managers, and their preferences regarding accounting recording and reporting systems were surveyed. The seeking of empirical evidence suggesting that either the cash basis or the simple accruals basis is appropriate to serve the financial information needs of owner-managers for owner-managed entities, was an important priority in the survey.

4 THE RESEARCH PROBLEM AND DESIGN

4.1 Introduction

The strongly regulated environment, within which corporate accounting practice evolves, has tended to pay lesser attention to owner-managed entities and the specific needs of its owners. This is demonstrated by the ongoing debate regarding the justification for a third tier of financial reporting (IFAC, 2006; IFAC, 2008).

In South Africa, the Companies Act (1973) had, before its recent amendment, forced companies to adhere to GAAP, regardless of size, ownership structure or users of financial statements. ED 163 followed the approach of excluding some statements of GAAP and specific sections of other statements of GAAP.

In the previous chapter, it was pointed out that researchers such as Page (1981) and Holmes, Kent and Downey (1991), hinted strongly that owner-managed entities have financial reporting priorities (within a limited user setting) different from those of publicly accountable corporations, calling for rethinking of the requirements for financial reporting at the lowest level, i.e. accrual versus cash-basis reporting. This implies that the extent of sophistication built into the accrual-basis model, should only be considered after the primary issue, being accrual versus cash-basis reporting, has been resolved. It follows therefore that if, and only if, the accrual basis is found to be indeed a suitable basis for owner-managed entities, the question of the extent of sophistication built into the accrual-basis model and the question whether measurement and recognition criteria (within the accrual-basis model) should be relaxed or not, becomes relevant.

The Corporate Laws Amendment Act (South Africa, 2006) acknowledged the different needs for financial reporting by distinguishing between “widely held” and “limited interest” companies, acknowledging the need for limited purpose financial statements. The financial reporting dispensation for limited interest companies, however, will evolve as the international debate on third tier financial reporting progresses.

At the time, the IWG argued in favour of a simple accruals system at the lowest tier of differential reporting.

Yet, the majority of the studies and positions fail to focus on the primary users of the accounting information. Most studies analyze the generated accounting information by its suitability for the prediction of future earnings, assuming that owners of small and medium entities would be interested in exactly this information.

Lee's (1972; 1981; 1983) studies pointed out different needs of primary users of financial statements, suggesting that cash and convertibility into cash is of primary importance and that certain accruals are more relevant than others in circumstances where survival is the primary focus of an entity. Collins and Jarvis (2002) found that SMEs, unlike large entities, focus on survival, autonomy and stability.

What then, are the unique information needs of owner managers and how would these needs be best served through different accounting basis used to record and report financial information? To understand the information needs of owner-managers, it seems obvious to approach them directly and to find out what they think would serve their needs best. Yet, this approach was impractical for various reasons. Firstly, the researcher would always run into problems of the correct sample size as the population is huge. Secondly, the author of this study experienced a strong lack of financial knowledge under the owner-managers of small entities. Therefore the owner-managers of small entities seek advice from their accountants. Especially for owner-managers of small entities, the intimate relationship must not be underestimated. A study of the information needs therefore should not focus on the person of the owner-manager only, but has to include the vital role of the accountant. Hence, the author has concluded that the research gap would best be served by taking the accountants as a proxy and analyzing their opinion with regards to the matter. Due to their daily work with owner-managers, the accountants offer a great source of knowledge and will provide valuable insight into the information needs of owner-managers and how these information needs

are best served through different accounting basis used to record and report financial information.

Using the accountants as proxy for the opinions of owner-managers, however, has its limitations. The author is well aware that the accountants might as well be biased towards their profession and may, under circumstances, believe that their service is exactly what the owner-manager wants; even if they might not see it. Therefore, the author of this study conducted in-depth interviews with a group of owner-managers to confirm the information received by the accountants. This triangulation strategy allowed controlling for a possible misinterpretation from accountants with regards to their clients' needs.

4.2 Research questions

4.2.1 *Main question*

What are the financial information needs of owner-managers of owner-managed entities and how are these financial information needs best served through different accounting basis used for the recording and reporting of financial information?

Clemens and Dyer (1979: 275) observed that the character and capability of a firm are judged by much wider observation than just the financial statements. It is therefore important to identify the performance indicators valued and understood by owner-managers, also those obtained from sources outside the annual financial statements, such as accounting records, budgets and accountants. Clemens and Dyer (1979) and Page (2004) found that owner-managers did specifically also rely on annual financial statements for financial planning, control and other financial decisions, while Page (2004) and Maingot and Zeghal (2006) found assessing profitability to be the most important use of financial statements by private company directors. Lee focused on the importance of cash and the convertibility into cash, for entities, such as many SMEs, who are in survival mode. The first category of sub-questions listed below therefore,

focuses on the preferences of owner-managers regarding accounting basis used for the recording and reporting of financial information.

4.2.2 *Sub-questions*

The sub-question is stated in each case as well as a brief description of the aim of the question:

Sub-question	Aim of question
<p>Are the accounting recording systems of owner-managed entities primarily cash based?</p>	<p>A cash-basis recording system would complement a cash-basis reporting system and it may give some evidence of the accounting expertise involved in the entity and if owner-managers are regularly exposed to cash and/or accruals based information.</p>
<p>What kind of financial decisions are actually made by owner-managers?</p>	<p>The nature of decisions would give better understanding of the need for cash-basis versus accrual-basis information.</p>
<p>Which basis of accounting (cash or accrual) best fits the performance indicators valued and understood by owner-managers?</p>	<p>To identify performance indicators used by owner-managers and whether they are available from sources outside annual financial statements. Furthermore it would highlight a possible preference, by owner-managers, for cash versus accrual-basis information.</p>

Sub-question (continued)	Aim of question (continued)
<p>What are the actual sources of information used by owner-managers for financial decision-making in their businesses?</p>	<p>To confirm the findings of Clemens and Dyer (1979) and Page (2004) that owner-managers regarding the value of annual financial statements and other sources of financial information for financial decision-making purposes.</p>
<p>Do owner-managers find accrual-basis financial statements understandable?</p>	<p>An indirect question to determine if perhaps the cash basis is not easier to understand than the accrual basis.</p>
<p>Which specific financial statement(s) are best appreciated by owner-managers for decision-making purposes?</p>	<p>A more direct question to determine if owner-managers indeed prefer the income statement (for assessing profitability) as found by Page (2004).</p>

The literature, however, indicates considerations, other than the mere preference of users of the financial information, in assessing the suitability of such information. In the Lee model (Lee, 1981a), cash-basis information is viewed as superior to information added by using the accrual-basis, on the basis of the former being factual data and the latter being judgmental data. Accrual-basis information, however, enhances understanding of more complicated transactions. The mere simplicity of the cash basis may therefore distort proper understanding of transactions. This potential trade off between simplicity and understandability of information, therefore, should be taken into account when arguing the suitability of financial information.

Loftus and Miller (2000) emphasized the influence of survival mode versus growth mode in an entity. In survival mode the time horizon of an entity is shorter, making cash information more relevant, whereas in a growth mode, the time horizon will be longer and the added value of accrual-basis information will be more relevant.

Financial recording and reporting may also have an implication for the financial discipline of an entity. Some government agencies, e.g. Ministry of Economic Development of New Zealand (2002), stated that the benefit of financial discipline must be weighed in considering cost versus the benefit of financial reporting.

Alderman (1982:53) found that the modified cash basis and the tax basis of financial reporting were commonly used by accountants in the USA. If similar practices are used by South African accountants, it may be indicative of their view on the suitability of accounting bases for owner-managed entities.

The category of sub-questions that follows has been designed to probe the above issues and their potential impact on an assessment of the suitability of financial information. Once again the sub-question is stated in each case as well as a brief description of the aim of the question:

Sub-question	Aim of question
<p>Do owner-managed entities have transactions of a complexity which, if disclosed in a cash-basis reporting system, may distort the proper understanding of the transactions?</p>	<p>To determine if owner-managed entities typically have non-cash transactions and what the nature of such transactions are.</p>

Sub-question (continued)	Aim of question (continued)
Do owner-managed entities have a time horizon which might be better served by a cash-basis than accrual-basis accounting system?	To determine if the time horizons of owner-managed entities add justification to deviate from the accrual-basis accounting or not.
Does compliance with certain financial recording and reporting practices contribute materially to the fostering of financial discipline in owner-managed entities?	To determine if the quest for financial discipline add justification for compliance with certain financial recording and reporting practices.
Do accountants support the deviation from a strict accrual-basis in the financial statements of close corporations?	To determine whether South African accountants tend to deviate from the accrual basis of accounting.

4.3 Research design and methodology

4.3.1 Research population and sampling method

The purpose of this study is to gain better understanding of the decision-making environment of owner-managers of owner-managed entities. The main theme is “useful financial statements” as opposed to “prescribed financial statements”, with a view to taking a fresh look at the unique needs of the smaller business environment.

Much of the literature available on differential reporting is written against the background of entities subject to corporate legislation and compulsory compliance with accounting standards, but the true target audience of this study are SMEs who do

not have in-house accounting expertise, are owner-managed, and do not enjoy significant public interest (United Nations, 2001: 10). For the aim of this study it is regarded as very important to access businesses small enough to be managed by owners, but still subject to at least some corporate reporting obligations. The approach was to target businesses that qualify as owner-managed entities, but at the same time would be directly or indirectly accessible. To achieve this, close corporations were targeted. The motivation for targeting close corporations from the population of owner-managed entities is set out in 4.3.3.

4.3.2 The pilot study and its impact on the research design

A research instrument comprising a 38 question questionnaire directed to one member (preferably the member in charge of the financial function) of the sampled close corporations, was designed and tested on a small sample of nine respondents. The sample was selected on a convenience basis. Three registered members of The South African Institute of Professional Accountants (SAIPA) who knew about the intended study, each volunteered to introduce the researcher to three of their clients who were members of different close corporations. The questionnaire comprised the following five sections:

- Section A: *Background questions on the specific corporation.*
- Section B: *Questions on the bookkeeping / financial information recording system in place in the specific corporation.*
- Section C: *Questions on the usefulness of existing annual financial statements and other sources of financial information.*
- Section D: *Questions on members' preferences regarding the financial information recording and reporting practices of the corporation.*
- Section E: *Questions on members' views on the merits of an audit (in general).*

Collectively, the responses of sections A to E would be analyzed to answer the research question regarding the financial information needs of owner-managers of owner-

managed entities and how these financial information needs are best served through different accounting recording and reporting systems.

The original questionnaire was adjusted to target accounting practitioners (see Annexure 1) to gain their understanding of what information the members of their close corporation clients found useful. The focus was still on the owner-manager, but as seen through the eyes of the practitioner. The number of questions was reduced to thirty. The researcher decided not to repeat the pilot study, because the adjustments made to the questionnaire in response to the pilot study done with the owner-managers were equally applicable to the revised questionnaire applicable to the practitioners. The questions were adjusted, however, to enlist a practitioner response instead of an owner-manager response. It must be noted, however, that some of the questions required the accountant to respond about their owner-manager clients, while other questions required a response from the accountant in the capacity as accountant.

The adjusted questionnaire was first completed independently by two practitioners to identify any remaining unclear issues.

- Having been invited by SAIPA to address its National Convention in Somerset West on International Accounting Standards, the researcher obtained the Institute's permission for the questionnaire to be administered at the convention.
- As a secondary procedure, semi-structured interviews would be conducted with a sample of owner-managers (accessed via SAIPA members who agreed to this) to determine whether the perceptions of practitioners about issues effecting their clients were actually confirmed by owner-managers themselves. This sample was never intended to be representative, because of the difficulty of obtaining access via the accountants (as explained above). Furthermore, given the need to explain the terminology used in the semi-structured interviews and the dispersion of the owner-managers in terms of the location of their businesses, it would not have been practicable to interview a large number of owner-managers. Nevertheless, it was felt that interviewing a

number of owner-managers would assist in the validating of the research. Alternatively, the interviews might have demonstrated to the researcher that the views of practitioners could not be extrapolated to the owner-managers.

4.3.3 Delineation of the study

The study was subject to the following limitations:

The main research instrument targeted only accounting officers (all members of the same accounting institute, SAIPA), focusing on their close corporation clients. Although a multitude of other owner-managed entities and accounting practitioners exist, the view was held that the chosen population was appropriate for the purposes of answering the chosen research question. The motivation for focusing on close corporations was as follows:

- The Close Corporations Act requires the application of GAAP, appropriate to the business; thereby setting a tone for differential reporting.
- By nature, close corporations are owner-managed, fulfilling a basic criterion to justify differential reporting.
- Close corporations are restricted to ten members, automatically excluding larger businesses with a significant public interest.
- Due to the statutory requirement that close corporations must have an accounting officer, access to entity information could be achieved through the accounting officer.
- The researcher was invited to administer a questionnaire targeting accounting practitioners at the National Convention of The South African Institute of Professional Accountants on 9 April 2005. By virtue of the nature of such a convention the delegates were geographically representative of South Africa.

The primary research instrument was used to probe the views of accounting officers, as proxy for owner-managers, about the financial information needs of their owner-manager clients and how these financial information needs are best served through

different accounting recording and reporting systems. As secondary research instrument, in-depth interviews were conducted with a group of owner-managers to validate the information received by the accountants. The secondary research was intended as a triangulation procedure of a qualitative nature and therefore no claims are made as to the representativeness of the sample.

The research focuses on the fundamental issues relating to differential reporting in the owner-managed SME context, being accounting basis (cash versus accrual) and suitability of recognition and measurement criteria. Literature on sophisticated measurement and recognition criteria, including issues such as fair value accounting, is excluded from this study.

The research focuses on the attitudes and needs of owner-managers of owner-managed entities and hence the structure of ownership as argument to justify differential reporting was emphasized rather than quantitative criteria such as turnover, number of employees or balance sheet total. No meaningful claims regarding the impact of entity size on owner-manager preferences can thus be made from this study.

4.3.4 Non-response bias

According to Saunders, Lewis & Thornhill (1997: 129) the three reasons for non-response bias are refusal to respond, ineligibility to respond, and non-contact. In the case of the questionnaire targeting the accounting practitioners, the sample comprised 243 delegates who attended the conference session offered by the researcher, and they all completed the questionnaire. Most of the responses of all the respondents were usable, and only a few responses to individual questions in the questionnaire were not usable. The response rate of individual questions in the questionnaire is indicated in the analysis of the questionnaire results and many of them are close to 100% (see Chapter 5).

5 ANSWERING THE RESEARCH QUESTION

5.1 Structure of the questionnaire targeting accounting practitioners

The questionnaire (Annexure 1) was structured to address the sub-questions relating to the main research question as set out in 4.2.2.

The first category of questions relate to user preferences in assessing the suitability of accounting basis used for the recording and reporting of financial information (the aim of each question was stated on pages 54 – 55):

- Are the accounting recording systems of owner-managed entities primarily cash based? (Question 4)
- What kind of financial decisions are actually made by owner-managers? (Questions 8, 15, 16)
- Which basis of accounting (cash or accrual) best fits the performance indicators valued and understood by owner-managers? (Questions 17, 18, 19)
- What are the actual sources of information used by owner-managers for financial decision-making in their businesses? (Questions 7, 9, 10, 13, 14)
- Do owner-managers find accrual-basis financial statements understandable? (Questions 11, 12 and 26)
- Which specific financial statement(s) are best appreciated by owner-managers for decision-making purposes? (Questions 9, 10, 11, 12)

The second category of questions relate to considerations indicated in the literature, other than user preferences, in assessing the suitability of accounting basis (the aim of each question was stated on pages 56 – 57):

- Do owner-managed entities have transactions of a complexity which, if disclosed in a cash-basis reporting system, would tend to distort the proper understanding of the transactions? (Question 5)
- Do owner-managers have a time horizon which might be better served by a cash basis than an accrual basis? (Questions 20, 21, 22, 23)

- Does compliance with sophisticated accounting standards contribute materially to the fostering of financial discipline in owner-managed entities? (Question 6)
- Do accounting practitioners support the deviation from a strict accrual-basis in the financial statements of owner-managed enterprises? (Questions 24, 25, 26)

It will be observed that some questions in the questionnaire are not directly relevant to the research question. In the quest of the researcher to make optimal use of the unique opportunity created by the SAIPA convention, some questions dealing with non-statutory audits of close corporations (Questions 27, 28 and 29) were included, to establish whether an independent attestation of financial statements would add to the usefulness of the financial statements. It may also be noted that the differential reporting literature is dominated by the debate pertaining to the relevance of recognition and measurement criteria as well as disclosure requirements in the quest to simplify GAAP, while the focus in this study is the more fundamental issue of cash-basis versus accrual-basis financial reporting.

5.2 Administering of the questionnaire targeting accounting practitioners

The researcher administered the questionnaire at the National Convention of The South African Institute of Professional Accountants on 9 April 2005, which made it possible to address 243 attending delegates in one venue. After a general introduction to differential reporting, the purpose and context of the research and the structure of the research instrument was explained, emphasising that the questionnaire primarily sought information relating to respondents' exposure to close corporation clients, and that the questionnaire was strictly anonymous. Some of the questions were intended to obtain the opinions of the practitioners in their capacity as preparers of financial statements for close corporations (Questions 4, 5, 6, 8, 9, 11, 12, 13, 19, 20, 21, 24, 25 and 26), while other questions sought their opinion on how the members of close corporations would perceive certain issues (Questions 7, 10, 14, 15, 16, 17, 18, 22 and 23). The

common theme, however, was to seek evidence to establish whether owner-managers base financial decisions primarily on either cash-basis or accrual-basis information or a hybrid of the two bases.

A general discussion of terms used in the questionnaire followed, after which all the respondents completed the questionnaire with the researcher in attendance. The respondents did not indicate that they needed any further assistance.

5.3 Interpretation of the questionnaire targeting accounting practitioners

The data provided by the practitioner questionnaire comprises descriptive data (for example respondents' years in public practice), ranked data resulting from Likert scale questions (for example the frequency of certain transaction types), and qualitative data (for example the open-ended question on aspects of financial statements that do not consider the specific needs of small businesses). For descriptive data, frequency tables were prepared to assist in the interpretation of the data, while for ranked data, tables detailed with frequency, mode, median, the mean, and a ranking based on the mean, were prepared.

In the case of qualitative data, responses were allocated to response categories. Saunders, Lewis and Thornhill (1997: 341) state that qualitative data should be classified into categories which are meaningful considering the purpose of the research. For each open-ended question, categories have accordingly been devised and the frequency of data categories has been presented in tables to enhance data analysis and interpretation.

The complete analysis of the questionnaire responses, including individual responses to open-ended questions, can be found in Annexure 2. In the main text, response tables have been summarized and the data is discussed, taking into account the related research sub-question. Absolute numbers of responses per category are shown in the annexure, while the main text tables focus on percentages of responses per category.

Question 1

How long have you been a practising member of CFA (SA)?

Please note that at the time of the survey, SAIPA still had the name Institute of Commercial and Financial Accountants of Southern Africa [CFA (SA)].

Table 5.1: Respondents' years in public practice

N*=243 R*=99%

Period	Responses
Less than one year	7%
One to five years	24%
Longer than five years	69%

* N is used to indicate the number of questionnaires completed; R is used to indicate the response rate for the question, using the following formula: number of responses/N x 100.

Sixty nine percent of the respondents have been practising as accounting officers for longer than five years, while ninety three percent of them (24% + 69%) reported that they have been practising for longer than a year. Based on such a level of experience, one would conclude that the perceptions of the respondents about owner-managers' understanding of and need for financial information, should be reasonably accurate.

Questions 2 and 3

How many members does the typical close corporation client have?

Are the members of your typical close corporations active in the business?

Table 5.2: Number of members for a typical close corporation client

N=243 R=99%

Number of members	Responses
One	19%
Two to five	78%
Six to ten	3%

Table 5.3: Members active in a typical close corporation

N=243 R=99%

Active members	Responses
All are active	44%
Most are active	52%
Few are active	4%

Ninety seven percent (19% + 78%) of the respondents indicated that their typical close corporation client has one to five members. Since the study focused on owner-management rather than on size to justify differential reporting, the questionnaire did not probe size indicators such as number of employees, balance sheet total or turnover amounts.

Ninety six percent (44% + 52%) of respondents indicated that most members are indeed active in their close corporations, therefore it might be concluded that the close corporations under review in the sample are being owner-managed.

Question 4

Which journals of first entry are typically used by your close corporation clients?

Table 5.4: Journals of first entry kept by typical close corporation client

N=243

R*=138%

R=100%

Journals	Responses	Respondents
Only cash journals	38%	53%
Cash journals and general journal	38%	53%
A comprehensive set of journals	24%	32%

* Each respondent would have had a number of clients, and the three categories were not mutually exclusive. The total response rate of 138% is therefore the result of some respondents choosing two of the three categories, which probably indicates that such respondents felt strongly that two of the three categories were equally prominent amongst their clients. The calculation of “responses” was therefore based on the actual number of responses (336) instead of the number of respondents (243). In the column on the extreme right hand side of the table, the response rate has been normalised to 100% by basing the calculations on the number of respondents instead of responses, in order to eliminate the effect of dual responses.

This question addresses the following sub-question of the research question: “Are the accounting (recording systems) of owner-managed entities primarily cash based?”

The answer is affirmative. Only twenty four percent of the responses (thirty two percent of respondents) indicated that the typical close corporation client maintained a comprehensive set of journals. Furthermore, it is interesting to note that thirty eight percent of responses (fifty three percent of respondents) reported that close corporation clients kept only cash journals.

The specific statistic is not as important as the indirect evidence that there is a strong cash focus and regular usage of cash-basis information by many owner-managers of

close corporations. The significant proportion of “recording cash only” systems amongst close corporation clients also implies that respondents are in a good position to comment on the usefulness of cash versus accrual-basis financial statements to their clients, while it indirectly implies that such “recording cash only” entities are unlikely to have internal accounting expertise, making them more dependent on their external accountants for sound understanding of financial statements.

Question 5

Which of the following (more advanced) transactions does your close corporation clients engage in?

**Table 5.5: Accrual-basis transactions incurred by typical close corporation
N=243 R=93% Percentage of responses**

Transaction type	Often	Sometimes	Never	Mean	Ranking
	3	2	1		
Foreign exchange	5%	54%	41%	1.6	4
Leases / hire purchase	66%	33%	1%	2.6	2
Revaluations	11%	65%	23%	1.9	3
Depreciation	87%	10%	3%	2.8	1

This question addressed the following sub-question of the research question: “Do owner-managed entities have transactions which, if disclosed in a cash-basis reporting system, would tend to distort the proper understanding of the transactions?” This suggests that judgmental data (as in the Lee model), supplied by only an accrual-basis of accounting, is necessary for a proper understanding of the essence of the transactions involved.

The answer is affirmative. Fifty nine percent (5% + 54%) of respondents indicated foreign exchange transactions as occurring Sometimes or Often. It is noteworthy that seventy six percent (11% + 65%) of the respondents indicated that asset revaluations

were recorded Sometimes or Often, and almost all the respondents indicated hire purchases or lease transactions and the depreciation of assets, resulting in respectively revaluation surpluses, capitalised assets and liabilities and accumulated depreciation in an accrual accounting system. This result cautions that, as observed by Eggington (1984:104), cash flow financial reporting “veils certain downside risks,” e.g. the operational risk of worn equipment on the one hand. On the other hand, it “gives sparse indication of the upside ‘potential’ of certain externally financed assets,” e.g. for example revaluation surpluses on non-monetary assets. It also strengthens the argument that cash-basis information cannot be used in isolation but should, as a minimum, be supplemented by some form of accrual-basis information.

Question 6

How good are each of the following practices, in your view, in fostering financial discipline in close corporations?

**Table 5.6: Activities fostering financial discipline in a typical close corporation
N=243 R=95%**

Activity	Very good	Good	Bad	Very bad	Mean	Ranking
	4	3	2	1		
VAT record keeping	54%	44%	2%	0%	3.5	1
Record keeping for AFS	42%	53%	3%	0%	3.4	2
Compliance to GAAP	23%	57%	17%	3%	3.0	3

Question 6 addresses the following sub-question: “Does compliance with sophisticated accounting standards contribute materially to the fostering of financial discipline in the owner-managed entities?”

As is expected, the keeping of VAT records ranks the highest amongst the listed activities fostering financial discipline. Interestingly, the majority of respondents still rated compliance with GAAP in the financial statements fairly high. It is difficult to

remove respondent bias in this question though, since they may regard GAAP compliance as indicative of how well they have fulfilled their responsibilities. The responses do indicate, however, that there are activities, other than compliance with GAAP, fostering financial discipline in an entity.

An insignificant number of respondents (only 11) commented under the “Another” category. (See Annexure 2, page 4) Interestingly, some of these comments referred to the monitoring of cash flow in the context of financial discipline.

Question 7

What, in your view, are the most important sources of financial information used by owner-managers of close corporations for decision-making in the corporation?

Table 5.7: Preferred sources of financial information used by owner-managers
N=243 R=99%

Sources	Very important	Important	Less important	Not important	Mean	Ranking
	4	3	2	1		
Bank statements	59%	30%	10%	1%	3.5	1
AFS	40%	37%	21%	2%	3.2	2
Management accounts	41%	38%	17%	3%	3.2	2
Budgets	32%	35%	23%	10%	2.9	3
Accounting records	29%	38%	29%	4%	2.9	3

Question 7 addresses the following sub-question: “What are the actual sources of information used by owner-managers for financial decision-making in their businesses?”

The recognition of bank statements as the highest ranking source for financial decision-making confirms the view that owner-managers are perceived to have a clear cash orientation in the way they think. Judging by the mean scores of the sources listed

in the question, budgets, annual financial statements, management accounts and accounting records are viewed essentially the same in terms of usefulness for financial decision-making. The responses make sense from the point of view that owner-managers do indeed have free access to all these sources of information. Furthermore, the high ranking of annual financial statements does confirm the observation of Page (2004) and Clemens and Dyer (1979) that owner-managers do value annual financial statements for decision-making purposes.

It is acknowledged that the use of bank statements and annual financial statements cannot be compared directly, therefore Question 7 must be read with Question 8, which tests whether there is a distinction between regular (more operational) decision-making and irregular (more strategic) decision-making.

Question 8

What kind of decisions do you associate with the sources of financial information you have indicated as important above? Distinguish routine (regular) decisions from irregular decisions if applicable.

Many responses to this fairly open-ended question had limited value, because they did not focus on the connection to the source of information and/or the routine of decisions as requested. The following table shows the areas of decision-making listed by the respondents, and the number of respondents who mentioned each area.

**Table 5.8: Categories of decisions based on certain sources of financial information
N=243 R=35%**

Categories of decision-making	Respondents
Cash and working capital management	21
Capital assets acquired / financed	17
Expansion of business	15
Budgetary control and cash projections	15
Strategic reflection (profitability etc.)	10

Categories of decision-making (continued)	Respondents (continued)
Finance approval	8
Tax calculations	7
Other (marketing, pricing, employees)	7
Valuations	4
Members' remuneration	4

Question 8 addresses the following sub-question: "What kind of financial decisions are actually made by owner-managers?"

Some responses supported the anticipated cash focus of owner-managers by comments such as:

- "If the bank balance is going the negative way, it is perceived that the business is not profitable."
- "Only wants to know if money is in the bank and if they can pay accounts."
- "Clients work on bank statements alone; accountant consulted for all other decisions."
- "I expected to make a profit and have cash in the bank-Why do I not? The bank is going to call for my financial results - am I going to be close to what I advised them (in cash) when I submitted my application for an overdraft?"

The above responses are viewed as qualitative in nature, and are therefore used to enrich the understanding of quantitative data. For example, if one looks at the overwhelmingly high ranking of bank statements in Question 7, the above statements regarding owner-managers' cash focus seem to provide some evidence of a very prominent (perhaps narrow) cash focus in the SME environment.

Only a few respondents hinted at the distinction between regular and irregular decisions. The cases where such a distinction was made by respondents are noted below, with the source of financial information mentioned in brackets:

Regular decisions:

- Timing of creditor payments (using bank statements).
- Timing of inventory purchases (using bank statements).
- Cash flow management in general (using bank statements).
- Members' loan account maintenance and distribution decisions (using management accounts and bank statements).
- Daily sales targets achieved (bank statements and other records).
- Cash flow projections (bank statements and other records).

Irregular decisions:

- Approval of overdraft facility (annual financial statements).
- Purchase of capital assets (annual financial statements).
- Determining tax liability (annual financial statements).
- Securing new finance (annual financial statements).
- Valuation of business for the purpose of buying or selling as well as changing members (annual financial statements).
- Going concern test (annual financial statements).
- Budget control (budgets and management accounts).

Other decisions necessitating accrual-based information

- Debt collection and other working capital strategy.
- Price increases.

Some respondents specifically stated that some members only understand bank statements. One respondent specifically mentioned "reconciled bank statements". More than one respondent observed that clients often do not ask for help or information at all before they take financial decisions.

The regular decisions listed are generally associated with bank statements while the irregular decisions are associated with accrual-basis information. Within the context of a smaller business, there seems to be a need for owner-managers to better understand

the transition from cash basis to basic accruals basis (before sophisticated accrual-basis financial reporting standards can be considered at all).

Question 9

Which of the following financial statements do you typically prepare for your close corporation clients?

Table 5.9: Financial statements typically prepared for close corporations

N=243 R=99%

Financial statement	Do prepare
Balance sheet	100%
Income statement	100%
Cash flow statement	83%
Statement of changes in net investment	68%
Statement of receipts and payments	26%
Cash flow statement and statement of receipts and payments	22%

Questions 9 and 10 address the following research sub-question: “Does the accountant’s choice of specific financial statements prepared for owner-managed clients give some evidence of cash versus accrual-basis preferences by the client?”

Section 58 of The Close Corporations Act of 1984 stipulates the income statement and balance sheet as statutory requirements, while the preparation of a cash flow statement (and to an extent the statement of changes in net investment) may be viewed by some accountants as being part of GAAP, appropriate to the entity. Hence the 100% Yes responses for income statement and balance sheet and 83% for cash flow statement and 68% for the statement of changes in net investment, were to be expected. A statement of receipts and payments, however, is prepared at the accountants’ discretion and therefore the responses around that are important. Twenty six percent of respondents indicated that they do prepare statements of receipts and payments, while twenty two

percent (fifty two respondents), indicated that they prepare both a cash flow and receipts and payments statement, which makes sense in view of later comments that the format of the cash flow statement is unfriendly. This may be interpreted as an attempt to simplify the financial statements for the needs of the owner-managers.

Question 12 will give more informative evidence of the quality of the (conventional) cash flow information typically provided in annual financial statements.

Question 10

How useful to the owner-managers of close corporations do you rate the financial statements (indicated in the previous question)?

**Table 5.10: Usefulness of specific financial statements to owner-managers
N=243 R=99%**

Financial statement	Very useful	Useful	Less useful	Not useful	Mean	Ranking
	4	3	2	1		
Income statement	64%	34%	2%	0%	3.6	1
Balance sheet	36%	51%	13%	0%	3.2	2
Cash flow statement	32%	27%	28%	13%	2.8	3
Statement of receipts and payments	19%	30%	32%	19%	2.5	4
Statement of changes in net investment of members	11%	21%	43%	26%	2.2	5

The respondents rate the accrual-basis income statement the highest of the listed statements, confirming that respondents do perceive profit assessment to be the most important use of financial statements, as found by Page (2004).

The cash flow statement and receipts and payments statement, rank respectively third and fourth position. The inclusion of a receipts and payments statement at all (by some

respondents) together with the fairly high ranking of the cash flow statement indicates that the majority of respondents find it useful to translate financial performance into cash terms. In this regard, it is again interesting to note that fifty two respondents reported that they typically prepare both a cash flow statement and a statement of receipts and payments.

Question 11

Do you regard the financial statements of close corporations in their current format as simple, user friendly and useful for management purposes?

Table 5.11: *Understandability and usefulness of financial statements to owner-managers*
N=243 R=97%

Feature	Yes responses
Simplicity	78%
User friendliness	77%
Usefulness	68%

Questions 11 and 12 address the following research sub-question: “Do owner-managers find accrual-basis financial statements understandable?”

Approximately seventy percent of the respondents perceive financial statements to be simple, user-friendly and useful for management decision-making. It is difficult to isolate the respondents’ bias resulting from both tradition and the fear that the quality of their service to their clients is challenged by this question. In this sense, it should be noted that more than twenty percent of respondents had reservations about the simplicity, user-friendliness and usefulness of existing financial statements. Question 12 gives more detail in this regard.

Question 12

Are there certain obvious aspects of financial statements which, in your view, do not consider the specific needs of smaller businesses (e.g. terminology used)?

Table 5.12a: Practitioner perception regarding financial statements considering the needs of smaller businesses

N=243 R=37%

Responses	Respondents
Yes	62
No	27

Table 5.12b: Specific aspects of financial statements not considering the needs of smaller businesses (as raised by the Yes respondents of table 5.12a)

N=62 R=100%

Aspect of AFS criticized	Respondents
The cash flow statement	21
Terminology and format	15
General understandability	15
GAAP	10
The balance sheet	1

Although the responses on open-ended questions like Question 12, are viewed as qualitative in nature, and therefore the frequency of a specific response cannot necessarily be generalized, it was noticed from the above table that sixty two out of the eighty nine responses to this question had some form of criticism regarding the understandability of financial statements of which twenty one focused on the cash flow. Some of the more revealing comments (especially regarding cash flow statements), are listed below:

- “The cash flow statement is seldom understood.”
- “The understanding of cash flow statements is a priority.”
- “Financial statements are not understood by the average close corporation member. It is our duty to explain them.”
- “Cash flow statement should be more detailed.”
- “Cash flow statement terminology.”
- “Cash flow statement not user friendly.”
- “Cash-basis statements are better understood.”

- “... not even banks understand cash flow in its current form.”

The comments in this question indicate strongly that practitioners intuitively realize that cash flow / cash basis information is important, but not necessarily in a conventional format. Owner-managers apparently think in a cash mode, yet the responses to Question 12 suggest that owner-managers find it difficult to understand cash flow statements and the terminology used in them. A contributing factor may be the extent to which the indirect approach is still used by accountants; owner-managers may find it hard to digest cash flow information derived indirectly from an accrual accounting model. In corporate reporting, the superiority of the direct method of cash flow reporting was emphasized by Bahnson, Miller & Budge (1996), Dritina & Largey (1985) and Jones and Ratnatunga (1997). The survey conducted by Jones and Ratnatunga (1997: 79) amongst Australian preparers of financial statements demonstrated that the direct method enhances user understanding. The practical preference for the indirect approach to cash flow reporting can be explained by the simplicity of preparation for the practitioner (using balance sheets and income statement as primary source), while the direct approach, as observed by Bahnson, Miller & Budge (1996), may require adjustments to the recording system to capture pure cash transactions.

If many entities in the SME environment, by preference, have a cash-basis recording system, adjusted afterwards by accountants to reflect accruals, the question still remains whether owner-managers would understand a similar approach to the financial statements better. This would imply that a cash-basis income statement becomes the primary financial statement and that the cash-basis profit is then adjusted to an accrual-basis profit figure.

Question 13

Who in your experience are the users of the annual financial statements of close corporations?

Table 5.13: Users of financial statements of close corporations

N=243 R=98%

User	Yes responses	Ranking
The bank	100%	1
SARS	99%	2
Owner-managers	82%	3
Suppliers	23%	4

Questions 13 and 14 address following research sub-question: “What are the actual sources of information used by owner-managers for financial decision-making in their businesses?”

The bank and SARS are reported to be the users in almost all the cases, while eighty two percent of the respondents also indicated the owner-managers as users. These findings therefore confirm the finding of Page (2004) that owner-managers do value financial statements, and Van Wyk’s (2005) finding that owner-managers are the most important user after SARS and the bank. At the same time, the eighty two percent “Yes” responses imply that some respondents felt that owner-managers do not really use the financial statements. This has also been confirmed by some of the responses in previous questions regarding the understandability of financial statements. Van Wyk (2005) has also made the observation that some owner-managers do not use the financial statements at all.

Question 14

To what extent, in your view, do the users (which you specified above) find the financial statements of the corporation useful in their current format?

Table 5.14: Usefulness of financial statements to different users

N=243 R=93%

Users	Very useful	Useful	Less useful	Not useful	Mean	Ranking
	4	3	2	1		
SARS	54%	40%	5%	1%	3.5	1
The bank	44%	51%	5%	0%	3.4	2
The owner-managers	30%	49%	18%	3%	3.0	3
Suppliers	15%	37%	29%	19%	2.5	4

The mean scores of the first two rankings differ by a very small margin. This may be the result of the respondents being slightly biased towards the usefulness of financial statements for SARS and the bank because they are usually personally involved in the annual submission of annual financial statements to both SARS and the bank, while they would find it more difficult to assess the usefulness of the financial statements to owner-managers and suppliers. Twenty one percent (18%+3%) of the respondents said that owner-managers find the financial statements “Less useful” or “Not useful”, as opposed to a small percentage of respondents who said the same about SARS and the bank. This could be expected, considering that more than twenty percent of responses for Question 11 indicated financial statements as not simple and user friendly enough. This is also consistent with the finding in question 13 that eighty two percent of owners-managers are perceived to find financial statements useful.

Only a few of the respondents identified perceived users other than the listed four (See Annexure 2, page 16), suggesting that, taking the low mean scores of suppliers into account, SARS, the bank and owner-managers are found to be the main users of annual financial statements.

Question 15

Do you think the financial statements of close corporations are used for the following purposes?

Table 5.15: Use of financial statements for specific purposes

N=243 R=97%

Use	Often	Sometimes	Seldom	Never	Mean	Ranking
	4	3	2	1		
Financial decisions	46%	42%	11%	1%	3.3	1
Planning	38%	44%	15%	3%	3.2	2
Affordability of owners' remuneration	37%	38%	20%	5%	3.1	3
Investment decisions	29%	48%	21%	2%	3.0	4

Questions 15 and 16 help to answer the following research sub-question: "What kind of financial decisions are actually made by owner-managers?" The responses must be interpreted cautiously, since some decisions are by nature more regular than others. The mean scores of all four decision categories are relatively equal. The important conclusion, though, is that respondents perceive all four types of decisions to be made with reference to financial statements, which are considered to be conventional accrual-basis financial statements. The responses to Question 8 suggested that the type of decision listed in Question 15 is taken irregularly, unlike cash management which is frequently confirmed to be done all the time. The "Sometimes" instead of "Often" choice of category therefore confirms a less regular frequency, but does not necessarily indicate that the category to be less important. Furthermore, the responses do not suggest that these decisions are necessarily made without practitioners' input.

Question 16

Elaborate on the type of decisions actually made using financial statements.

Although Question 8 also dealt with decision-making, this was more in the context of various sources of information, while Question 16 focuses specifically on the financial statements. The following table shows the areas of decision-making listed by the respondents, and the number of respondents who mentioned each area:

Table 5.16: Types of decisions informed by financial statements

N=243 R=40%

Area of decision-making	Respondents
Finance approval	26
Tax calculations	23
Strategic reflection (profitability etc.)	20
Members' remuneration and loans	10
Valuations	10
Expansion of business	8
Budgetary control and cash projections	7
Capital assets acquired / financed	4
Other (marketing, pricing, employees)	4

The same categories of comments were identified as in Question 8, except for cash and working capital management, which is not expected to be an area of decision-making associated with financial statements. It is also noticed that twenty respondents to question 16, alluded to the use of financial statements for the purpose of a strategic reflection. Amongst this category were comments such as the following:

- "Where can I make savings to be able to make a profit?"
- "Viability of business. Breakdown of expenditure incurred."
- "... an annualized set gives an overall perspective..."

Ten respondents emphasized the specific importance of the financial statements as an instrument to base members remuneration on profits. Some of the comments were as follows:

- “Members remuneration must be in line with profitability of business as shown in AFS.”
- “Financial statements used when working out members’ remuneration.”
- “Very few – distributions to owners.”

A few respondents, however, did comment that financial statements do not have any value for the owner-managers. The comments made, were as follows:

- “Owners decide irrespective of financial statements.”
- “None by owner.”
- “Most of the members only look at the financial statements when we discuss it and never again. They only use it for their overdrafts, loans and SARS.”
- “...just to get rid of legalities.”

Owner-members seem to get bogged down in their daily cash management which, although it cannot be argued to be unimportant, appears to prevent them from shifting their perspective to the bigger picture. Looking at the comments above from a qualitative point of view, begs the question whether the perspective that financial statements provide an annual reflection to improve operations is not perhaps a vital aspect, hence this question was specifically posed in the semi-structured interviews (See Annexure 4, Question 18).

Question 17

How are the following indicators of financial performance rated by owner-managers in your view?

Table 5.17: Perceived rating of financial performance indicators

N=243 R=98%

Indicator	Very good	Good	Bad	Very bad	Mean	Ranking
	4	3	2	1		
Turnover	66%	32%	2%	0%	3.6	1
The bank balance	54%	44%	2%	0%	3.5	2
Profit/loss per income statement	43%	51%	6%	0%	3.4	3
A cash surplus/ or deficit	45%	45%	10%	0%	3.3	4

Questions 17, 18 and 19 help to answer the following research sub-question: “Which basis of accounting (cash or accrual) best fits the performance indicators valued and understood by owner-managers?” More than half the respondents have rated both turnover and the bank balance as very good performance indicators. Turnover ranks the highest, while the cash surplus ranks the lowest. Although the cash surplus ranks the lowest of the four, it still scores relatively highly. It is noted that the two highest ranking indicators are found outside financial statements as well. The ranking of the bank balance as performance indicator once again seems to confirm the focus of owner-managers on cash measures. It is clear from the “another financial performance indicator” category (See Annexure 2, page 21) that some practitioners educate their clients in the use of financial ratios, especially gross margin.

Question 18 helps to interpret the role of the time horizon within which these performance indicators are used.

Question 18

How often, in your view, do owner-managers actually use the indicators of financial performance (as rated above)?

The detailed responses to this question can be viewed in Annexure 2 on pages 22 to 27. It is noted that the majority of respondents did not distinguish between the different performance indicators for the purpose of answering the question, hence such comments were not very useful for assessing the time horizon within which specific performance indicators are used. The responses to the question were divided into four categories and are summarized in the table below:

**Table 5.18: Perceived frequency of use of performance indicators
N=243 R=74%**

Response category	Respondents
Twice a year or less	88
More than twice a year	84
Varies	13
Never	6

Most respondents agreed that the performance indicators listed in Question 17 are indeed used. It is acknowledged, though, that even though a performance indicator may be used less frequently, it may still be very important. The responses simply emphasise that entities have different time horizons and therefore the issue was probed further in Question 24 of the structured interviews with owner-managers.

Some respondents, however, did distinguish amongst the different performance indicators when they assessed the frequency of use of performance indicators. Those responses follow below:

- “Cash surplus/ bank balance – daily; turnover – monthly; profit/loss – monthly.”
- “Bank balances monitored on short periods.”

- “Sales monthly; bank daily; profit bi annually; cash surplus often.”
- “Turnover and cash flow often.”
- “Sales – always; bank balance – regularly; profit (available too late).”
- “Sales all the time; bank balance – quarterly.”

These responses, as the ones in Question 8, again emphasize short term cash management.

In Question 19, the format which a cash performance measure should take is probed.

Question 19

If you have indicated before that cash surplus (or deficit) figures and/or profit (loss) figures are valued as indicators of financial performance; indicate how useful you regard the following types of surplus (deficit) and profit and loss figures.

Table 5.19: Usefulness of different performance measures

N=243 R=90%

Indicator	Very useful	Useful	Less useful	Not useful	Mean	Ranking
	4	3	2	1		
A cash surplus resulting from all receipts less all payments	44%	44%	10%	2%	3.3	1
A cash surplus resulting from all receipts of operating nature less payments of operating nature	36%	46%	15%	3%	3.2	2
Profit determined per tax legislation	29%	42%	21%	8%	2.9	3
Cash generated from operations per cash flow statement	25%	37%	29%	9%	2.8	4
Profit determined per GAAP	16%	42%	32%	10%	2.6	5

The “cash surplus resulting from all cash receipts less all payments” is a very simple measure that can be produced by a cash-basis system and yet it ranks the highest. It is also the only indicator with a mode of 4 (Very useful). The second and fourth rated indicators are in essence the same thing, except that in the mind of the accounting practitioner, the second rated one is probably associated with a cash basis, while the

fourth one is associated with an accruals basis of accounting. "GAAP profit" ranks lowest. Although cash-basis indicators ranked both first and second out of the four listed items, it is interesting that "cash generated from operations per cash flow statement" ranks lower than a tax basis measure, which can be viewed as a simple accrual-basis. Again the impression is strengthened that cash-basis indicators are indeed in demand, but in a more user-friendly format than conventionally presented in cash flow statements.

The business environment sketched so far is one within which the "financial literacy" level of many owner-managers forces them to depend on simple and readily available performance indicators like turnover and the bank balance. What is lacking, though, is a more strategic reflection on the outcome of the range of shorter term decisions, all based on short-term performance indicators. The owner-manager seems to need an understandable set of financial statements which supports his or her "cash value system."

Question 20

How important is it, in your view, that financial statements confirm the ability of the business to afford the owners' remuneration (salaries, interest on capital, members' salaries etc.)?

Table 5.20: Perceived importance of financial statements confirming that owner distributions are based on profits

N=243 R=98%

Very important	Important	Less important	Not important
48%	38%	10%	4%

Questions 20, 21, 22, 23 help to answer the following research sub-question: "Do owner-managers have a time horizon which might be better served by a cash basis than an accrual-basis? "

Eighty six percent (48% + 38%) of the respondents rated the confirmation of owners' remuneration as either "Very important" or "Important", while only four percent of the respondents rated this as "Not important". Some responses from Question 16 (as quoted on page 82) also confirmed the importance of this confirmation function of financial statements.

The next question specifically addressed the issue of clarity of disclosure.

Question 21

Do you think existing financial statements can be clearer on this aspect?

The majority of respondents (who did respond) answered in the affirmative to this question, as indicated in the table below:

Table 5.21: *Clarity of existing financial statements on owners' distributions being based on profits*
N=243 R=54%

Responses	Respondents
Yes (i.e. the financial statements can be clearer)	89
No (i.e. they are clear enough)	43

Some of the stronger views are quoted below:

- "Absolutely"
- "Yes, the real implications of "overdrawing" and the effect on sustainable income are important".
- "No, the user must just interpret the information correctly".

The comment voiced in the third bullet above raises the issue of education versus simplicity of format and disclosure. The accounting practitioners understand the importance of owners' remuneration being based on profits, yet they are faced with the

challenge of bringing the message across to their clients. It therefore makes sense that they would prefer financial statements to be clearer on that aspect.

The next question focuses on the time horizon of owner-managers.

Question 22

Which one of the following three financial values are mostly nurtured by owner-managers of close corporations in your view?

Table 5.22: Perceived financial values of owner-managers

N=243 R=103%

Financial value	Responses
To support owners' life style	36%
Financial growth (beyond the needs of the owner)	36%
Survival of the corporation	28%

Eight respondents chose more than one option, contrary to the question instruction, hence the response rate of 103%. Both the options "To support owners' lifestyle" and "Survival of the corporation" imply short-term time horizons focusing on making ends meet in cash terms. The responses show that practitioners perceive a considerable number of owner-managers as having a shorter term time horizon. It is within this lower order survival-of-business-and-owner context that it becomes important for financial statements to flag the danger of "overdrawing" by clearly indicating the affordability of members' remuneration (as reflected in Questions 20 and 21).

Question 23

Which other values (not necessarily financial) are nurtured by owner-managers of close corporations in your view?

The table guiding the interpretation of Question 23, follows:

Table 5.23: Perceived non-financial values nurtured by owner-managers

N=243 R=97%

Value	Percentage of responses
Stability	72%
Autonomy	27%
Other: Sustainability	1%

Seventy two percent of respondents favoured “Stability”, while only twenty seven percent chose “Autonomy”. The low percentage for the “Autonomy” option is not expected, because one would think that owner-managers who value their autonomy are the ones who would choose against financial growth which might require third party involvement in the business. This issue was therefore probed further in the semi-structured interviews.

Question 24

If you had a free hand to redesign the financial statements of close corporations from scratch, to what extent would you support the following suggested changes?

Table 5.24: Support for suggested changes in financial statements

N=243 R=93%

Suggested changes	Fully support	Support	Some support	No support	Mean	Ranking
	4	3	2	1		
Appropriate GAAP	40%	34%	17%	9%	3.1	1
Restrict complicated transactions to notes	27%	40%	23%	10%	2.8	2
Tax values where possible	25%	37%	25%	13%	2.8	2
Cash transactions with selected accruals	26%	32%	25%	17%	2.7	4
In full compliance with GAAP	20%	29%	32%	19%	2.5	5
Only cash transactions	9%	18%	24%	49%	1.9	6

Questions 24, 25 and 26 help to answer the following research sub-question: “Do accounting practitioners support the deviation from a strict accrual-basis in the financial statements of owner-managed enterprises?”

The question dealt with the accountants’ own opinions rather than their perceptions of owner-managers’ views, hence it is not surprising that existing practice for close corporations, being “Appropriate GAAP”, ranks the highest (respondents bias may be present). Yet the two second, and the fourth ranked alternatives shows reasonable support for the so-called other comprehensive basis of accounting as practised in the USA.

Van Wyk’s (2005) finding that the two pure approaches, a strict cash-basis of financial reporting and full GAAP, enjoyed less support than other options, was also confirmed in this study. This emphasizes the view that cash-basis measures should supplement rather than replace accrual-basis measures.

Question 25

Elaborate on the aspects of financial statements in which you support change.

Like previous open-ended questions, the interpretation of this question is approached from a qualitative point of view. As indicated in detail in Annexure 2, pages 35 to 37, many general comments were made by respondents. These comments are divided into response categories and are summarized in the table below:

**Table 5.25: More detail on suggested changes to financial statements
N=243 R=28%**

Response category	Respondents
Do not support any change	14
Change notes and individual sections	10
Make financial statements more user friendly in general	9

Response category (continued)	Respondents (continued)
Apply appropriate GAAP	8
No or different cash flow statement needed	9
Change balance sheet values	6
Add an additional statement	4
Apply cash or simple accruals basis	4
Add features (eg. performance indicators)	4

Nine respondents appealed that the cash flow statement must either be simplified or discarded, while another four suggested that a cash basis or simple accruals basis is appropriate for certain business settings. The following two responses reflected a strong view on cash-basis reporting:

- “Owner-managers are mostly interested in the survival of the entities, so they are mostly interested in the cash flows...” This respondent stated further that other aspects of financial statements were secondary to the cash focus.
- “For micro entities only cash transactions, for medium entities cash and limited credit transactions, big entities full GAAP.”

The golden thread of a need for cash-basis information, but not the conventional cash flow statement, is also clear in these responses.

One respondent took the view that financial statements should be simple enough for owners to understand fully without explanation from accountants. Another respondent explained as follows why simplification could be destructive: “Although the owners don’t look at the financials they base their decisions on the accounting officer’s opinion. I need to be able to base my opinion on a reliable and exact statement.” Yet another respondent (of four in that response category) made the prudent remark that the answer does not necessarily lie in an either or scenario; “Additional statements could be added to the existing ones”.

Question 26

Do you think it is necessary to simplify financial statements for smaller businesses at all? Motivate your answer.

This question was intended to be a last resort for respondents to give a personal opinion on the merits of simplification of financial statements.

The respondents were expected to first say “Yes” or “No” and then to motivate their opinion. The following tables summarise the Yes / No responses as well as response categories for the yes or no responses (not all respondents provided motivations):

Table 5.26a: Practitioner perceptions of the need for simplification of AFS
N=243 R=68%

Responses	Respondents
Yes	121
No	45

Table 5.26b: Practitioner motivations for supporting simplification of AFS
N=121 R=74%

Motivation category for “yes” responses	Respondents
To enhance owner-manager understanding	38
To enhance/encourage owner-manager decision-making	14
Financial statements should focus on bottom-line (eg; profit figure)	11
Discard cash flow statement	9
Financial statements not relevant to owner-manager	8
Cost-benefit considerations	5
Cash focus should be strengthened	3

Table 5.26c: Practitioner motivations for not supporting simplification of AFS

N=45 R=24%

Motivation category for “no” responses	Respondents
Rather educate / assist owner-managers to understand	7
Simplification will dilute usefulness of financial statements	4

The majority of respondents supported simplification. Most motivations focused on the advantage to be gained from simplification rather than the method of simplification itself, and many comments were made on the possible enhancement of understandability and usefulness of financial statements for owner-managers. Some respondents felt that usefulness could be achieved specifically by simplification resulting in a better focus on the bottom-line of performance measurement, while others again brought up the issue of the cash flow statement not being useful.

The proponents of not simplifying financial statements were concerned about oversimplification that could render information useless. Some of them made an appeal to focus on educating owner-managers, rather than simplifying financial statements.

The very recent focus group study commissioned by IFAC (2008) has found simplicity to be of key importance for a third tier of financial reporting (IFAC, 2008: 57).

Question 27, 28 and 29

Are the financial statements of your close corporation clients audited?

To what extent, in your view, would the following possible benefits of an annual audit apply to corporations subject to audit?

How important, in your view, is an unqualified audit report?

The tables guiding the interpretation of Questions 27, 28 and 29, follows:

Table 5.27: Audit frequency of close corporations

N=243 R=96%

Audit frequency	Responses
Annually	7%
Sometimes	29%
Never	64%

Table 5.28: Benefits of an annual audit

N=243 R=93%

Possible benefit	Very applicable	Applicable	Less applicable	Not applicable	Mean	Ranking
Enhancement of credibility	23%	38%	19%	20%	2.7	1
Fraud detection	14%	30%	27%	29%	2.3	2

Table 5.29a: Importance of an unqualified audit report

N=243 R=94%

Very important	Important	Less important	Not important
37%	37%	17%	9%

Table 5.29b: Motivation for view of the importance of an unqualified audit report

N=243 R=23%

Motivation category	Respondents
Enhances credibility to third parties	42
Qualification does not have an impact	14

Since an audit is not a statutory requirement for a close corporation, it was interesting that thirty six percent (29% + 7%) of respondents indicated that their close corporation clients are audited. The strongest motivation for such a voluntary audit appears to be the enhancement of credibility of the financial statements. Furthermore, the majority of respondents regarded an unqualified audit report as either “Important” or “Very

important” and, most of respondents felt an unqualified audit report enhances the credibility of financial statements.

Some of the comments, specifically directed to the close corporation context, were as follows:

- “...irrelevant for CC...”
- “A qualification may be only due to non compliance with GAAP and not critical to the AFS.”
- “In a small business no one ever looks or worries about the qualification.”
- “Never received a comment of any kind on a qualified audit report.”

The majority view of the respondents, however, appears to support the observation made in the IFAC Information Paper on Micro Entities (IFAC, 2006), reporting that many small entities subjected themselves to an audit even if not legally required to do so, often to provide an independent verification function (IFAC, 2006:15). The focus group research published in 2008 (IFAC, 2008: 57), confirmed general support for some form of attestation attached to the financial statements of micro entities.

5.4 Summary of conclusions based on practitioner questionnaire interpretation

Research sub-question	Conclusions based on practitioner questionnaire analysis
<p>Are the accounting recording systems of owner-managed entities primarily cash based? (Question 4 in the practitioner questionnaire)</p>	<p>In many cases only cash journals, or cash journals and general journals, are maintained. Owner-managers of such entities will therefore have a clear understanding of the cash basis and as a consequence they are likely to understand cash-basis financial reporting better.</p>

Research sub-question (continued)	Conclusions (continued)
<p>What kind of financial decisions are actually made by owner-managers? (Questions 8, 15 and 16 in the practitioner questionnaire)</p>	<p>Decisions such as buying inventory or paying creditors are perceived to be taken regularly, often using only bank statements (which is in effect cash-basis information). Investment and finance decisions and decisions regarding owners' remuneration are taken less regularly, often after accountants were consulted, who do rely on accrual-basis information. Owner-members appear to find it difficult to bridge the gap between their day to day cash perspective and the big picture presented in the form of accrual-basis financial statements.</p>
<p>Which basis of accounting (cash or accrual) best fits the performance indicators valued and understood by owner-managers? (Questions 17, 18 and 19 in the practitioner questionnaire)</p>	<p>Owner-managers are perceived to use both cash-basis and simple accrual-basis performance indicators. They value the use of the bank balance per bank statement and turnover figures. Both these performance indicators are available outside the financial statements. Profit and cash measures, obtainable from financial statements are also used, but understandability apparently limit the use thereof.</p>

Research sub-question (continued)	Conclusions (continued)
<p>What are the actual sources of information used by owner-managers for decision-making in their businesses? (Questions 7, 9, 10, 13, 14 in the practitioner questionnaire)</p>	<p>Practitioners confirm the findings of Clemens and Dyer (1979) and Page (2004) that owner-managers do value conventional accrual-basis financial statements for financial decision-making purposes, especially the income statement. They do also, however, perceive bank statements to play a major role especially in day to day decision-making by owner-managers. Although statements of cash flow are typically prepared their actual usefulness for decision-making purposes is doubtful.</p>
<p>Do owner-managers find accrual-basis financial statements understandable? (Questions 11, 12 and 26 in the practitioner questionnaire)</p>	<p>Accounting practitioners perceive many owner-managers to have a basic understanding of accrual-basis financial statements. Cash flow statements (as part of accrual-based financial statements) are specifically mentioned as not being understandable, which is noteworthy because many small entities in fact have predominantly cash-basis recording systems.</p>

Research sub-question (continued)	Conclusions (continued)
<p>Which specific financial statement(s) are best appreciated by owner-managers for financial decision-making purposes? (Questions 9; 10; 11 and 12 in the practitioner questionnaire)</p>	<p>Owner-managers are indeed perceived to prefer the income statement (for assessing profitability) as found by Page (2004). Accountants prefer accrual-basis financial statements to cash-basis statements and prepare income statements and balance sheets for their close corporation clients.</p> <p>Although they often prepare cash flow statements as well, they feel that owner-managers often do not understand the cash flow statements in their conventional format.</p>
<p>Do owner-managed entities have transactions of a complexity which, if disclosed in a cash-basis reporting system, would tend to distort the proper understanding of the transactions? (Questions 5 in the practitioner questionnaire)</p>	<p>Yes, the majority of entities do have such transactions. A pure cash basis would therefore dilute the information content of financial statements, especially the ability to predict future cash flows.</p>
<p>Do owner-managers have a time horizon which might be better served by a cash basis than an accrual basis? (Questions 20, 21, 22 and 23 in the practitioner questionnaire)</p>	<p>The accounting practitioners perceive many owner-managers to operate in a shorter term time horizon, in a mode of struggling to afford their own standard of living and letting the business survive. This short term time horizon is probably an important reason why practitioners</p>

Research sub-question (continued)	Conclusions (continued)
<p>Does compliance with sophisticated accounting standards contribute materially to the fostering of financial discipline in owner-managed entities? (Question 6 in the practitioner questionnaire)</p>	<p>acknowledge that it is important that financial statements should clearly show whether members' remuneration is based on profits.</p> <p>There are compensating financial activities contributing towards financial discipline in close corporations, such as record keeping for VAT purposes. Financial discipline need not be considered in the choice of accounting basis.</p>
<p>Do accounting practitioners support the deviation from a strict accruals basis in the financial statements of owner-managed enterprises? (Questions 24, 25 and 26 in the practitioner questionnaire)</p>	<p>Practitioners support deviation from a strict accruals basis with caution, because they are well aware that such a deviation does not represent appropriate GAAP, which is a requirement of the Close Corporations Act. Practitioners are also afraid that over-simplification can render information useless. They do make a strong appeal for the enhancement of usefulness of financial statements for owner-managers, but they are not clear as to what the suitable solution to the problem is.</p>

5.5 Answer to the main question (based on the Practitioners' Questionnaire)

What are the financial information needs of owner-managers of owner-managed entities and how are these financial information needs best served through different accounting basis used for the recording and reporting of financial information?

Accounting practitioners themselves prefer accrual-basis financial information to cash-basis information. They use accrual-basis annual financial statements to reflect on an entity in a strategic way and prefer financial statements to comply with accounting standards as far as possible, given cost-benefit restrictions. They often assist their clients in financial decision-making, using the big picture presented by the annual financial statements.

Accounting practitioners have the perception that many close corporations use predominantly cash-based financial recording systems and owner-managers are well versed in day-to-day cash management. The view of the practitioners is that many owner-managers operate in a survival mode where in effect this short-term cash management approach dominates the way they operate. Furthermore, owner-managers are perceived to have a strong cash focus, further confirmed by the cash-basis financial performance indicators which they seem to cherish, implying that they would find cash-basis financial reports simple to understand. Most close corporations, however, do have transactions of the complexity which would dilute the usefulness of the financial statements if cash-basis reporting were used. At the same time, practitioners feel that owner-managers do find accrual-basis annual financial statements useful, especially the income statement. Regardless of their apparent strong cash focus, owner-managers often find statements of cash flow confusing.

Accountants perceive many owner-managers to prefer cash-basis information to accrual-basis information for short-term financial decision-making purposes. Owner-managers in survival mode often stay in that mode, hence accrual-basis information, enabling them to make better predictions of future cash flows, does not appeal to them.

The simplicity and understandability of the cash-basis system, however, does not take away the fact that accrual-basis information is required for a longer term view on an entity and its sustainability.

Why then do owner-managers find the cash flow statement confusing? Perhaps owner-managers would value an annual (or more regular) strategic reflection on their respective entities more if they could find a better link between their personal cash-basis performance indicators and proper accrual-basis financial statements. This question was probed further in the semi-structured interviews conducted with owner-managers.

6. CONFIRMING THE ANSWER TO THE RESEARCH QUESTION

6.1 Administering semi-structured interviews targeting owner-managers

6.1.1 *Introduction*

Struwig and Stead (2001) made the following important observations regarding qualitative research:

- Relatively small samples are used with few claims made regarding the wider representativeness of the sample (Struwig and Stead, 2001: 17).
- The interplay of contextual and individual factors is facilitated by the use of methods such as interviews and observation, enabling the respondent to expand on statements given to provide a more thorough explanation (Struwig and Stead, 2001: 17).
- Validity may be enhanced by using more than one research method (Struwig and Stead, 2001: 19).
- The interpretation of quantitative data is often of qualitative nature, which still needs to be converted into information insights and knowledge (Struwig and Stead, 2001: 19).
- Qualitative research can generate hunches, or an initial understanding of something which could be tested by more formal research.

The semi-structured interviews were indeed used to further probe some of the findings of the questionnaire research. At the same time the interviews provided insights which may only be validated by further research.

6.1.2 *Sample selection method*

The semi-structured interviews were intended to be qualitative research, adding value to the survey done amongst the accountants. The questionnaires administered at the SAIPA convention were completed by SAIPA members in their capacity as accounting officers of close corporation clients. These accounting officers acted as surrogates for

the owner-managers. The semi-structured interviews enabled the researcher to assess the reasonableness of using the accounting officers as surrogates. The questionnaire used for the semi-structured interviews was informed by the responses of the practitioners; especially on the open ended questions. It was never the intention therefore to obtain a sample size sufficient for statistical analysis, but rather to gain a better understanding of issues mentioned by the practitioners and to create an opportunity to probe further and clarify responses as objectively as possible.

Convenience sampling was therefore used to choose 20 participants for the semi-structured interviews. The justification for convenience sampling is as follows:

- The second research instrument was simply meant to further validate the findings of the other research instrument, since the opinions of accountants were used as proxy for that of owner-managers.
- Access to the busy owner-managers of smaller businesses or their staff is problematic, as was revealed in the pilot study.
- Being semi-structured interviews, it was argued that this part of the research is qualitative and therefore representativity was thought to be less of an issue. Although the practitioner survey did not reveal significant differences in responses based on different entity sizes, the researcher did include entities of different sizes in the interview sample to better simulate the variety of entity sizes on which the practitioners based their responses. A few sole traders and private companies were also included in the sample, because the real criterion for inclusion was owner-management and not legal form.

6.1.3 Individuals interviewed

The criteria really used to choose the individuals interviewed, were as follows:

- An owner-manager personally, if possible.
- A person who, according to the owner-manager, had sufficient experience and knowledge to speak on his or her behalf.

At the time the pilot study was run (See 4.2.2, page 46), it became evident that in smaller businesses, positions are not clear-cut, and therefore the person's title is not indicative of his or her ability to answer the interview questions.

6.1.4 Development of the semi-structured interview questionnaire

The semi-structured interview questionnaire was developed out of the practitioner questionnaire, after the responses from the practitioner questionnaire were fully analysed. Saunders, Lewis and Thornhill (1997: 213) explain that semi-structured interviews are qualitative research instruments that can be used to explore and explain themes which have emerged from the use of a questionnaire, and that they can also be used to validate the findings that emerged from the use of questionnaires. Hence, some questions were taken directly from the Practitioner Questionnaire and adjusted to reflect the owner-manager view (Questions 13, 14, 15, 19, 20, 21, 24, 25, 26, 27, 28, 29, 30 and 31). Some questions were added to further determine owner-manager understanding of the accrual basis (Questions 11, 12, 22 and 23). Questions 16, 17, 18 and 32 were based on responses from the Practitioner Questionnaire. The researcher did not deem it necessary to run a separate pilot study for the semi-structured interviews, because the analysis of the responses from the Practitioner Questionnaire showed the potential pitfalls and, since the researcher would be in an interactive interview with the respondent, misunderstanding could be clarified immediately. The first interview did not reveal any problem, hence the questionnaire was used for the remaining interviews without any further alterations.

Annexure 3 comprises the semi-structured interview questionnaire used in the interviews.

6.1.5 Interview process

The researcher conducted all twenty of the interviews personally after appointments had been made with the respondents. After the purpose and context of the research was explained, each question was read from the questionnaire and notes of the responses were made in the demarcated space provided on the questionnaire. The average time taken per interview was 45 minutes. Interviewees were not assisted with the answering of questions.

6.1.6 Approach to the analysis of open-ended questions

Saunders, Lewis and Thornhill (1997: 341) state that qualitative data should be classified into categories which are meaningful considering the purpose of the research. For each open-ended question, categories have been devised accordingly and the frequency of data categories has been presented in tables to enhance data analysis and interpretation.

The twenty interview questionnaires were numbered and in Annexure 4, the essence of the comments made by each interviewee was captured next to the questionnaire number, whilst the allocation of comments to categories, meaningful to answering the research question, is also shown in the annexure. The researcher also considered the potential value of unique statements made by individual respondents. In cases where a link between questions emerged, the responses were also summarized per respondent per question to assist in the interpretation of such links.

6.2 Interpretation of semi-structured interviews

The profile of the entities interviewed (Questions 1 to 9).

Twenty businesses were interviewed, of which fourteen were close corporations, three private companies, and three sole traders. In most cases the main member / shareholder

/owner, or somebody taking responsibility for the administrative function was interviewed.

In all the cases, ownership comprised of fewer than five persons, most of them active in management. This is in line with the profile of client entities as perceived by the accounting practitioners, except that no entity with more than five owners was included in the sample. The largest ownership was a company with five shareholders, of whom three were in management and the other two ordinary employees. The sample used for the semi-structured interviews was indeed drawn from an owner-management environment.

The number of employees ranged from nil (in one case) to forty three. Most of the entities interviewed, though, had more than five employees.

The sample included manufacturers, traders and the providers of services and all the participants, except one, had been in business for longer than five years.

In all cases but one, an owner or employee performed basic bookkeeping in-house. Most of these in-house accountants had very limited accounting literacy. The majority of them used PASTEL for bookkeeping. All participants also had professional accountants who were responsible for the preparation of the annual financial statements.

To what extent do the owners of the business depend on the (outside) accountant for advice in financial decision-making? (Question 10)

Eleven of the twenty participants indicated that they used the accountant only for technical and tax- related advice. Six indicated that the accountant had a large role in financial decision-making, while the remaining three indicated that the accountant had a small role in financial decision-making.

Does the business buy on credit? (Question 11)

Does the business sell on credit? (Question 12)

Table 6.11.12: Frequency of credit sales and purchases transactions

N=20 R=100%

	Always	Often	Seldom	Never
Purchases	5	8	5	2
Sales	4	4	2	10

Eighteen of the twenty participants have credit transactions. Their view on cash-basis versus accrual-basis accounting is therefore relevant.

Which journals of first entry are being used to record the transactions of your business?

(Question 13)

The responses from the Practitioners' Questionnaire (Question 4) indicated that a considerable number of owner-managed businesses keep mainly cash journals. The interviewed owner-managers confirmed this result. The twenty participants' responses are summarized below:

Table 6.13: Journals of first entry used to record transactions in the business

N=20 R=100%

Only cash	A comprehensive set	Less formal records
8	11	1

The category "cash journal and general journal" was not chosen by any participant, because the external accountant does the general journal. One participant indicated that bank statements and own VAT records are the only records from which the outside accountant draws up the annual financial statements. Some participants keep inventory and sales records in separate systems. Although the systems of most participants do

accommodate credit transactions, there are those who only have cash journals but track their debts by controlling the invoices specifically.

Which of the following (more advanced transactions), does your corporation engage in?
(Question 14)

Table 6.14: Accrual-basis transactions incurred in business
N=20 R=235% (Alternatives not mutually exclusive)

Foreign exchange	Leases/HP	Revaluation	Depreciation
10	14	4	19

The only transactions mentioned under the category “other”, were certain complicated freight duties (an importer) and royalties for licences (manufacturer of swimwear).

The responses of the accountants are once again confirmed, namely that the typical owner-managed firm has transactions of a complexity which, if disclosed in a cash-basis reporting system, would tend to distort the proper understanding of the transactions.

Which accounting practices do you regard as important to maintain financial discipline in your business? (Question 15)

Table 6.15: Accounting practices fostering financial discipline in the business
N=20 R=100%

Response category	Respondents
The full system as maintained at present	16
Records regarding individual contracts	2
Records needed to calculate profitability	1
Bank statement scrutiny	1

The accounting practitioners had the perception that certain accounting practices such as keeping VAT records are regarded highly by owner-managers for maintaining financial discipline in an entity. The question was put to the interviewees in a more open form and the result was surprising. Sixteen out of the twenty participants said without hesitation that they would maintain the full existing system even if it was not needed for taxation and other statutory purposes. The four participants who disagreed were the two building contractors who emphasized that the quotes which they prepare for their clients are the real backbone of their financial systems, while the third participant felt that close scrutiny of bank statements was adequate and the fourth one said that keeping sales, purchases and expense records was adequate.

The accountants ranked compliance with GAAP the lowest amongst the listed three practices for maintaining financial discipline and, likewise, the participating owner-managers did not even mention compliance with accounting standards at all.

How often are the following financial decisions (listed separately below) being performed? (Question 16)

Which sources of information do you use to take the decisions? (Question 17)

These two questions attempt to shed further light on the accounting practitioners' perceptions about relative usefulness of different sources of financial information to owner-managers and the type of financial decisions actually taken by the owner-managers. The interview questionnaire prompted each of the aspects listed below.

The timing of settling of debts to suppliers.

Table 6.16a: The timing of settling debts owed to suppliers

N=20 R=100%

Response category	Respondents
Daily	3
Monthly	13
Seldom	2
Never	2

Table 6.17a1: Information consulted before settling supplier- debts

N=20 R=60%

Response category	Respondents
Bank statements	10
Management accounts	2

Table 6.17a2: Other responses regarding settling supplier- debts

N=18 R=100%

Response category	Respondents
Paid on fixed terms where possible	13
Informed primarily by availability of cash	5

For sixteen out of the twenty participants, the settling of debts is a daily or monthly occurrence. Of the eighteen participants who bought on credit, thirteen paid on fixed terms of thirty days or longer, while the other five paid strictly when cash was available. Ten of the eighteen participants always consulted their bank statements before they paid. Past financial statements were not used. Two participants reported that they were informed by their management accounts before they paid their suppliers. It is interesting to note that the participants who maintain management accounts all have a comprehensive accrual-basis accounting system (See Annexure 4, page 20).

The timing and amounts of members' remuneration

Table 6.16b: The timing of members' remuneration

N=20 R=100%

Response category	Respondents
Daily	6
Monthly	9
Seldom	5

Table 6.17b: Information consulted to determine distributions to owners

N=20 R=120% (Alternatives not mutually exclusive)

Response category	Respondents
Bank statements	6
AFS	8
Budgets	3
Management accounts	5
Accountant's advise	2

Table 6.16.17b: Other responses regarding distributions to owners

N=18 R=100%

Response category	Respondents
Informed by owners' needs and/or cash available	9
Informed by accrual-basis information	11

Six of the participants took cash daily, while the majority drew a monthly salary and the remaining five drew remuneration only on an annual basis.

In nine of the cases, participants indicated or implied that members' remuneration was determined more by personal need than affordability by the business, resulting in them drawing all available cash. This means that their needs inform the size of the business

rather than the other way round. Eleven participants, however, indicated that they based their owners' remuneration decision on accrual-basis information, including annual financial statements, management accounts and/or their accountant's advice. Although some of them made drawings regularly, the decision regarding how much they should draw was based on what the business can afford.

The purchase of inventory.

Table 6.16c: *The timing of inventory purchases*

N=20 R=100%

Response category	Respondents
Daily	17
Monthly	1
Seldom	1
Never	0

Table 6.17c: *Information consulted before inventory purchases*

N=19 R=100% (Alternatives not mutually exclusive)

Response category	Respondents
Bank statements	3
AFS	0
Budgets	1
Management accounts	0
Accountant's advice	0

Table 6.16.17c: *Other responses regarding inventory purchases*

N=19 R=100%

Response category	Respondents
Informed by demand and minimum inventory levels	19

Participants indicated that purchases were unavoidable and must be made to satisfy demand (and / or to maintain minimum inventory levels). Only three indicated that they specifically consulted bank statements before ordering. This makes sense, since eighteen participants indicated that they purchase on credit.

The choice of capital assets and their financing.

Table 6.16d: *The timing of acquisition of capital assets*

N=20 R=100%

Response category	Respondents
Daily	0
Monthly	2
Seldom	16
Never	0

Table 6.17d: *Information consulted before acquisition of capital assets*

N=18 R=100% (Alternatives not mutually exclusive)

Response category	Respondents
Bank statements	4
AFS	1
Budgets	1
Management accounts	0
Accountant's advice	1

Table 6.16.17d: *Other responses regarding acquisition of capital assets*

N=18 R=100%

Response category	Respondents
Informed by need as it arises	11
Informed primarily by finance method	7
Informed primarily by accountant's advice	1

Eighteen of the twenty participants indicated that they did buy capital assets, although not regularly. Thirteen of them indicated that the decision to buy capital assets was simply made on a needs basis (replacement or expansion activities). Once an acquisition is made, the finance implications are being managed as part of short term cash management as amounts become payable (see the timing and settlement of debts section on page 109). Four participants indicated that they paid cash where possible (consulting bank statements beforehand). Only one participant indicated that he consulted the annual financial statements, his budget and asked for the accountant's advice before choosing a capital asset and the appropriate method of finance.

Budget preparation or maintenance.

Table 6.16e: The timing of budgetary activities

N=20 R=100%

Response category	Respondents
Daily	0
Monthly	3
Seldom	7
Never	10

Table 6.17e: Information consulted for budgetary activities

N=10 R=170% (Alternatives not mutually exclusive)

Response category	Respondents
Bank statements	2
AFS	5
Budgets	2
Management accounts	6
Accountant's advise	2

Half the participants did not use budgets at all. Most of the ten who did make use of budgets have a quarterly, half yearly or yearly routine. Five indicated that they used financial statements to inform the budget, six used management accounts (including four who use financial statements and management accounts) and only two were informed by bank statements. Only one participant indicated that only cash information was used to prepare the budget. This implies that most of the participants who use budgets, use accrual-basis information to prepare and maintain them.

Member's loan maintenance.

Table 6.16f: *The timing of members' loan maintenance*

N=20 R=100%

Response category	Respondents
Daily	0
Monthly	0
Seldom	5
Never	15

Table 6.17f: *Information consulted for members' loan maintenance*

N=5 R=120% (Alternatives not mutually exclusive)

Response category	Respondents
Bank statements	0
AFS	3
Budgets	0
Management accounts	1
Accountant's advise	2

The five respondents who identified the maintenance of members' loans as a decision-making area all agreed that such accounts needed to be done in compliance with accrual accounting principles.

Employee salary and bonus decisions.

Table 6.16g: The timing of employee remuneration decisions

N=20 R=100%

Response category	Respondents
Daily	0
Monthly	0
Seldom	17
Never	3

Table 6.17g: Information consulted before employee remuneration decisions

N=17 R=100% (Alternatives not mutually exclusive)

Response category	Respondents
Bank statements	0
AFS	3
Budgets	2
Management accounts	2
Accountant's advice	0

All the participants who have employees agreed that salary and bonus decisions are made annually. Only five regarded accounting information as influencing this decision at all, while none indicated that bank statements informed this decision. The drivers of the decision were indicated as follows:

Table 6.16.17g: Other responses regarding employee remuneration decisions

N=17 R=100%

Response category	Respondents
Decision primarily driven by industry	9
Decision primarily driven by cost	2
Decision primarily driven by accounting information	5
Decision primarily driven by performance	1

Employee and salary decisions are mainly driven by industry factors, leaving the entity with a month to month cash flow management problem.

To request (or secure) an increased credit facility.

Table 6.16h: The timing of increased credit facilities

N=20 R=100%

Response category	Respondents
Daily	0
Monthly	0
Seldom	17
Never	3

Table 6.17h: Information consulted before increased credit facilities

N=18 R=100% (Alternatives not mutually exclusive)

Response category	Respondents
Bank statements	1
AFS	14
Budgets	5
Management accounts	2
Accountant's advice	0

Of the seventeen who indicated the requesting or securing of increased credit facilities as an activity, all except one indicated it as an annual event. Fourteen indicated that they submit annual financial statements to the bank for the purpose, while three indicated that they did not need to make any submission to the bank.

Financial comparisons.

Table 6.16i: *The timing of financial comparisons*

N=20 R=100%

Response category	Respondents
Daily	0
Monthly	8
Seldom	8
Never	4

Table 6.17i: *Information consulted for financial comparisons*

N=14 R=100% (Alternatives not mutually exclusive)

Response category	Respondents
Bank statements	0
AFS	5
Budgets	1
Management accounts	8
Accountant's advice	0

Sixteen participants indicated that they did financial comparisons. Five of them listed the annual financial statements as a source for such comparisons, while in eight cases management accounts were the prime source. In some other cases customized records were used for the purpose, because the comparison routine was often monthly.

This implies that in the majority of the cases, accrual-basis information was used in making the comparisons.

Price increases of products or services.

Table 6.16j): *The timing of price increases*

N=20 R=100%

Response category	Respondents
Daily	13
Monthly	1
Seldom	6
Never	0

Table 6.17j): *Information consulted for price increases*

N=18 R=100% (Alternatives not mutually exclusive)

Response category	Respondents
Bank statements	0
AFS	1
Budgets	1
Management accounts	2
Accountant's advice	0

Table 6.16.17j): *Other responses regarding price increases*

N=17 R=110% (Alternatives not mutually exclusive)

Response category	Respondents
Decision driven by the market	8
Decision driven by cost	9
Decision driven by unique factor	5

All twenty participants indicated that they increase prices of their products or services, but only two of them do it after using information from the accounting system. The main drivers of price changes are summarized in Table 6.16.17j) above.

In the majority of cases (thirteen out of twenty) price increases were made very often.

Cash flow projections.

Table 6.16k: The timing of cash flow projections

N=20 R=100%

Response category	Respondents
Daily	0
Monthly	2
Seldom	6
Never	12

Table 6.17k: Information consulted for cash flow projections

N=8 R=100% (Alternatives not mutually exclusive)

Response category	Respondents
Bank statements	0
AFS	1
Budgets	1
Management accounts	3
Accountant's advice	0

Table 6.16.17k: Other responses regarding cash flow projections

N=8 R=100%

Response category	Respondents
Prepared from accrual-based information	4
Zero based stand alone projections	4

Only eight participants indicated that they sometimes do cash flow projections. For four of them this entailed simply a forecast for the purpose of a stand alone project, without the need of information from the accounting system, while the other four used information from accrual-basis information for the purpose.

Expansion of business.

Table 6.16l: The timing of expansion

N=20 R=100%

Response category	Respondents
Daily	5
Monthly	0
Seldom	7
Never	8

Table 6.17l: Information consulted before expansion

N=12 R=100% (Alternatives not mutually exclusive)

Response category	Respondents
Bank statements	1
AFS	2
Budgets	1
Management accounts	3
Accountant's advise	0

Table 6.16.17l: Other responses regarding expansion

N=12 R=100%

Response category	Respondents
Informed by cash-basis information	1
Informed by accrual-basis information	4
Informed by entity unique factors	7

Eight participants indicated that their firms never expanded. Of the twelve participants whose firms have expanded, four based the decision on accrual accounting information, one based it on cash information, while the remaining ones explained that the expansion was not treated as a financially-driven decision.

Calculation of taxation due.

Table 6.16m: *The timing of tax calculations*

N=20 R=100%

Response category	Respondents
Daily	0
Monthly	0
Seldom	20
Never	0

Table 6.17m: *Information consulted for tax calculations*

N=20 R=105% (Alternatives not mutually exclusive)

Response category	Respondents
Bank statements	0
AFS	20
Budgets	0
Management accounts	1
Accountant's advise	0

All the participants comply with taxation legislation (via their outside accountants) using accruals based financial statements to do tax calculations.

Valuation.

Table 6.16n: *The timing of valuations*

N=20 R=100%

Response category	Respondents
Daily	0
Monthly	0
Seldom	10
Never	10

Table 6.17n: *Information consulted for valuations*

N=10 R=100% (Alternatives not mutually exclusive)

Response category	Respondents
Bank statements	0
AFS	3
Budgets	0
Management accounts	1
Accountant's advise	6

Six of the ten participants who regarded business valuation to be an area of decision-making all regarded this as a once off activity for which they would consult their outside accountants who would by implication use accrual-basis information to do a valuation. The remaining four participants have done valuations themselves, three of whom used “rule of thumb” approaches, while the fourth one used an accruals based approach.

Recruiting staff.

Table 6.16o: *The timing of recruiting staff*

N=20 R=100%

Response category	Respondents
Daily	1
Monthly	1
Seldom	8
Never	10

Ten of the twenty participants regarded this as a business activity that did come up from time to time. They all saw it as a needs-driven instead of a finance-driven decision.

Marketing

Table 6.16p: *The timing of marketing*

N=20 R=100%

Response category	Respondents
Daily	4
Monthly	2
Seldom	5
Never	9

Eleven of the participants had marketing activities. Once again they did not see it as a financial decision-making area at all.

Debt collection

Table 6.16q: The timing of debt collection

N=20 R=100%

Response category	Respondents
Daily	3
Monthly	4
Seldom	2
Never	11

Ten participants have only cash sales (Table 6.11.12, page 106) and one of them makes use of invoice factoring. The remaining nine participants have a debt collection system. All regarded the system itself was important (which is an accrual-basis system by nature).

Most of the perceived areas of financial decision-making by owner-managers listed by the accounting practitioners were actually confirmed by the owner-managers interviewed. The interviewees, however, felt that marketing, recruitment of staff, employee salary and bonus decisions, price increases, purchases of inventory, choice and financing of capital assets are most often dominated by non-financial factors, leaving them in a position of no choice other than to incur the related transactions and to face the consequences in the form of short-term cash flow management. The number one ranking by the accounting practitioners of bank statements as, the perceived prime source of financial decision-making, though, was put in much better perspective by the interviews. This emphasised that owner-managers often find that non-financial factors such as demand for products and unavoidable replacement of capital assets dictate their cash flow in an ongoing juggle to match cash inflows and outflows.

Interviewees indicated further that activities such as budget preparation, cash flow projections, setting amounts of members' remuneration, maintaining members' loan

accounts, compliance with SARS and doing valuations are dependent on accrual-basis information.

Do you reflect on an annual basis (or more regularly on the financial position and performance of the business? If yes, elaborate on the way in which you do it (Question 18).

Table 6.18: Annual strategic reflection

N=20 R=100%

Response category	Respondents
Reflect at least annually using AFS	17
No reflection exercise	3

One of the conclusions from the Practitioner Questionnaire regarding the actual sources being used by owner-managers for financial decision-making (5.4, page 85) was that cash-basis information was associated by owner-managers with routine decisions, while the irregular decisions seemed to be associated with accrual-basis information. The interpretation of Questions 16 and 17 of the semi-structured interviews added the perspective that owner-managers often feel forced into the mode of constant short-term cash management as result of perceived unavoidable events such as needs driven replacement of capital assets. At the same time, some interviewees indicated that they do take advantage of accrual-basis information from both annual financial statements and management accounts to do proper budgets, maintain loan accounts, determine affordable members' remuneration etc.

One of the practitioner responses to Question 16 of the practitioners' Questionnaire (Annexure 2, page 20) suggested that one of the most important functions of the annual financial statements was that of annual reflection to look holistically at the business, while quite a few practitioners perceived owner-managers to be totally ignorant regarding annual financial statements. Question 18 of the semi-structured interviews

was meant to determine whether interviewees carried out such an annual reflection and if so, whether they found it useful.

Seventeen of the participants indicated that they regarded the annual reflection as an absolutely essential exercise to give a broad direction to the business. Three of them did this reflection parallel to their budgeting exercise. In four cases the external accountant led the reflection. In other cases the members' preferred to do it on their own. In most cases the annual financial statements were the basis for the reflection.

Can you distinguish the parts of annual financial statements: income statement, balance sheet and cash flow statement (perhaps statement of receipts and payments)? How often do you use them? (Question 19)

Table 6.19: Distinguishing parts of financial statements

N=20 R=100%

Response category	Respondents
Understand only income statement	10
Understand both the income statement and the balance sheet	6
Understand income statement, balance sheet and cash flow statement	1
Do not understand any one of the statements	3

In the accountants' perception of usefulness of certain statements to the owner-managers, the income statement was ranked first, balance sheets second and cash flow statement third. The interviews confirmed the importance of the income statement. The added perspective, though, was that the income statement was often the only understood statement. With the perspective of where the bank statement actually fitted in (as a day to day cash management tool) it was now clear that its value cannot really be compared with that of the income statement and cash flow statement, which do measurements over a year.

Only one interview respondent claimed to understand the cash flow statement. This also confirmed the various comments made by accountant respondents (Question 12, page 76 – 77), stating that the cash flow statement was not understood by their clients. Most interview respondents were fairly comfortable with income statements, while their understanding of balance sheets appeared to be dependant on their accounting literacy and the assistance of their external accountants. The number three ranking for usefulness of the cash flow statement by accounting practitioners made sense in the context of their own understanding of it.

Do you regard the financial statements in their current format as simple and user friendly enough to understand properly? (Question 20)

According to the responses to the Practitioner Survey, approximately seventy percent of the respondents perceived financial statements as simple, user-friendly and useful for financial decision-making purposes. The table below summarises the semi-structured interview respondents' assessment of simplicity and user-friendliness in response to Question 20:

Table 6.20: Understandability of accrual-basis AFS

N=20 R=100%

Response category	Respondents
Yes, simple and user friendly enough	10
No, not simple and user friendly enough	8
No opinion	2

Four of the ten interviewees who indicated yes, reiterated that they did not quite understand the balance sheet and deemed the cash flow statement irrelevant.

Amongst the suggestions for improvement, were the following:

- need for improved cash orientation
- strong need for an additional “one page” explanatory statement (3 participants)
- improvement of terminology.

Are there certain obvious aspects of financial statements which, in your view, do not consider the specific needs of smaller businesses? (Question 21)

Table 6.21: Needs of small business ignored in AFS

N=20 R=100%

Response category	Respondents
Terminology can be friendlier	2
Cash flow senseless, balance sheet to difficult	2
Needs a better link to the cash position	3

In response to Question 21 two respondents again alluded to their inability to understand the cash flow statement, while another three thought some form of cash portrayal was preferable.

This study gradually shows that accrual-basis financial reporting is the preferred basis of reporting, from the point of view of both accountants and owner-managers, but there is also evidence that cash flow statements are not understood by owner-managers.

The term “turnover” or “sales” has most value to you if it includes:

Invoiced work or cash received? (Question 22)

The term “purchases has the most value to you if it includes:

Invoiced work or cash paid? (Question 23)

These questions were not part of the Practitioner Questionnaire. The high ranking of bank statements as a source of information for owner-managers by practitioners, however, has raised the question whether owner-managers prefer to think in cash terms. The following table summarises the responses of the interview respondents:

Table 6.22: Most meaningful basis for sales

N=20 R=100%

Response category	Respondents
Invoiced work	15
Cash received	5

Table 6.23: Most meaningful basis for purchases

N=20 R=95%

Response category	Respondents
Invoiced work	16
Cash received	3

Clearly the majority of owner-managers understood that an invoice signaled business activity, even though the cash had not yet been paid or received. In some businesses it is quite possible that a transaction might be cancelled before the cash had changed hands. It made sense that in such a business the owner-manager would rely more strongly on cash flow (e.g. the real estate agent, respondent number 18).

It is also noted that an owner-manager associating sales and purchases with cash flow, may find it very hard to understand the essence of accrual accounting.

How often do you use each of the following indicators of financial performance for your business? (Question 24)

Any other comments on indicators of financial performance? (Question 25)

The interview respondents confirmed the exact ranking of the accounting practitioners regarding the listed four performance indicators with the bank balance and turnover used by most (and most often), while profit figures were used less often and cash surplus figures almost not used at all. A summary of the interview responses follows:

Table 6.24: Timing for use of performance indicators

N=20 R=100%

	Daily/weekly	Monthly	Once/twice a year	Job / transaction context	Never
Bank balance	16	0	0	0	4
Turnover	8	7	0	2	3
Profit figure	0	4	5	1	10
Cash surplus/deficit	0	1	0	0	19

The low score of the cash surplus / deficit can be understood in the context of the existing reporting structure of entities not emphasizing it. Three respondents specifically mentioned that they perceive the profit per income statement to be close to the cash surplus. The one respondent who did indicate that the cash surplus / deficit was a monthly indicator, mentioned in response to Question 19 that a customized statement, the so-called cash movement statement, was prepared for this purpose.

After also summarizing all the performance indicators used per respondent (see Annexure 4, page 41), it became clear that less frequent use does not deem an indicator unimportant, for example eight of the nine respondents who indicated profit or loss per income statement as performance indicator, also made use of the bank balance or turnover. Ten of the respondents used three or more performance indicators.

Is it clear to you which amounts you can use for personal purposes without jeopardizing the smooth operating of the business? (Question 26)

Table 6.26: Clarity on affordability of owners' remuneration

N=20 R=100%

Response category	Respondents
Clear and based on a personal needs and cash available approach	8
Clear but based on a cash available approach	9
Not relevant, because personal needs inform size of operations	3

Many accounting practitioner respondents indicated that the financial statements should be clearer on this aspect.

Seventeen interview respondents claimed that they did know how much they could draw from the business, while three of them mentioned that the question does not apply to them, because their personal needs informed the business regarding the desired capacity at which it should operate rather than vice versa. Nine of the twenty interview responses to Question 17 (Table 6.16.17b, page 110) indicated that members' remuneration was based on a spur of the moment decision instead of accrual-basis profitability.

The general agreement amongst the interviewees that they know how much to draw, may therefore rest on false grounds (determined by cash availability), which emphasizes the importance of an annual reflection (in accruals terms) to base drawings on true profits.

The practitioners concern about clarity of the financial statements regarding affordability of members' remuneration, is therefore understandable.

Which of the listed three financial values are best nurtured by you and the other owners of the corporation? (Question 27)

The accounting practitioners responded that a considerable number of owner-managers were driven by the two lower level values, namely survival and supporting current life-style. The summary below shows that the interview respondents confirmed the perception of the practitioners:

Table 6.27: Financial values of owner-managers

N=20 R=125% (Alternatives not mutually exclusive)

Response categories	Survival	Supporting current life style	Financial growth
Respondents	6	8	11

Some practitioner respondents (Table 5.22, page 88) marked more than one value. Likewise, three of the interviewees did the same and explained that in harder times the business tended to sometimes slip back to lower values.

Which other values are nurtured by you and the other owners of the corporation? (Question 28)

The accounting practitioners perceived stability to be most valued by owner-managers, while the majority of interviewees thought autonomy of the owners to be very important. Some of the interviewees actually confirmed this to be an important consideration in their decision not to grow their businesses much. The interview responses were as follows:

Table 6.28: Non-financial values of owner-managers

N=20 R=155% (Alternatives not mutually exclusive)

Response categories	Stability	Autonomy	Other
Respondents	6	11	14

The other values are all product quality, customer and people related.

Is it really necessary to simplify financial statements at all? (Question 29)

Table 6.29: Need for simplification of financial statements

N=20 R=100%

Response categories	Yes	No	No opinion
Respondents	10	4	6

In their response to the above question (table 5.26c, page 93), some accounting practitioners emphasised that simplicity in the financial statements could compromise their usefulness to users, while others emphasised simplicity for the sake of owner-managers.

The responses by the interviewees confirmed the same tension. Ten participants agreed that the financial statements should be simpler, but the following opinions were also raised:

- Education is a better way of simplification.
- An additional statement may be the answer.
- An accountant who explains, is a better way of simplification.
- Complete statements are required for other purposes.

A compromise solution to the problem would be that a user-friendly additional financial statement may encourage owner-managers to base strategically important decisions on accrual-basis financial statements.

Are the financial statements of this corporation sometimes audited? (Question 30)

The practitioner responses indicated that a minority of close corporations sometimes subjected themselves to a voluntary audit, because the owner-managers believed that it improved the credibility of the financial statements. Of the fourteen close corporations in the sample, only one indicated that an audit was sometimes conducted, for the specific purpose of invoice factoring.

6.3 Summary of conclusions based on all research results

The table below indicates to what extent the findings of the semi-structured interviews actually confirmed those of the accounting practitioner questionnaire.

Issues addressed in sub-question, and sub-question	Question number in accounting practitioner questionnaire	Question number semi-structured interview	Conclusions
<u>Recording systems</u> Are the accounting recording systems of owner-managed entities primarily cash based?	4	13	Many owner-managed entities indeed keep primarily cash recording systems, but many also keep creditors and debtors journals. General journal entries are often added by external accountants to convert the information to the accrual basis.

Issues addressed in sub-question, and sub-question (continued)	Question number in accounting practitioner questionnaire (continued)	Question number semi-structured interview (continued)	Conclusions (continued)
<p><u>Financial decisions</u></p> <p>What kind of financial decisions are actually made by owner-managers?</p>	8; 15; 16	16; 18	<p>Accountants and owner-managers alike, agree that a variety of decisions with financial implications are indeed taken. Many decisions such as recruitment of staff and inventory acquisition are driven by non financial factors forcing the owner-managers into tricky short-term cash management.</p> <p>Decision-making areas dependent on accrual-basis information (including annual financial statements) such as budget preparation and profitability based members' remuneration crop up less frequently but are often very important for the long-term survival of an entity.</p>

Issues addressed in sub-question, and sub-question (continued)	Question number in accounting practitioner questionnaire (continued)	Question number semi-structured interview (continued)	Conclusions (continued)
<p><u>Performance indicators</u></p> <p>Which basis of accounting (cash or accrual) best fits the performance indicators valued and understood by owner-managers?</p>	<p>17; 18; 19</p>	<p>22; 24; 25</p>	<p>The role of accrual-basis annual financial statements as a basis for a strategic annual reflection by owner-managers is strongly confirmed by owner-managers. The usefulness of such strategic reflection may be enhanced by simplification of financial statements.</p> <p>The bank balance and turnover alike are frequently used but some owner-managers do realize that for more strategic purposes, such as preparing budgets, they do need to resort to accrual-basis performance indicators as well.</p> <p>Turnover, based on invoiced work as opposed to cash receipts, is well understood</p>

Issues addressed in sub-question, and sub-question (continued)	Question number in accounting practitioner questionnaire (continued)	Question number semi-structured interview (continued)	Conclusions (continued)
<p data-bbox="245 922 513 990"><u>Sources of information</u></p> <p data-bbox="245 1048 513 1397">What are the actual sources of information used by owner-managers for financial decision-making in their businesses?</p>	<p data-bbox="539 936 735 972">7; 9; 10; 13; 14</p>	<p data-bbox="815 936 900 972">17; 18</p>	<p data-bbox="973 582 1353 878">by owner-managers. Profit, which is also an accrual-basis measurement, is used less, but is well understood by those owners-managers using it.</p> <p data-bbox="973 1012 1353 1146">Bank statements are used on an ongoing basis for cash flow management.</p> <p data-bbox="973 1169 1353 1464">Depending on the nature of the business and the financial literacy of the owner-managers, budgets and accruals based management accounts are used by some.</p> <p data-bbox="973 1487 1353 1783">Accrual-basis annual financial statements are still viewed as very valuable by many owner-managers for an annual reflection, primarily on financial performance.</p>

Issues addressed in sub-question, and sub-question (continued)	Question number in accounting practitioner questionnaire (continued)	Question number semi-structured interview (continued)	Conclusions (continued)
<p><u>Understandability</u> Do owner-managers find accrual-basis financial statements understandable?</p>	<p>10; 11; 12; 20; 21</p>	<p>19; 20; 21; 22; 23; 26</p>	<p>Many owner-managers appear fairly comfortable with the accrual-basis income statement and, to a lesser extent, with the balance sheet. However, many of them feel very uncomfortable with cash flow statements. The bank balance is important to them, but only as a day to day cash management device.</p>
<p><u>Financial statements</u> Which specific financial statements are best appreciated by owner-managers for financial decision-making purposes?</p>	<p>9; 10; 11; 12</p>	<p>19</p>	<p>Owner-managers find income statements useful. The usefulness of balance sheets depends on owner-managers' financial literacy and the assistance of the accountant. They do not find cash flow statements useful at all.</p>

Issues addressed in sub-question, and sub-question (continued)	Question number in accounting practitioner questionnaire (continued)	Question number semi-structured interview (continued)	Conclusions (continued)
<p><u>Transaction complexity</u> Do owner-managed entities have transactions of a complexity which, if disclosed in a cash-basis reporting system, would tend to distort the proper understanding of the transactions?</p>	5	14	Many owner-managed firms have transactions of a complexity which, if disclosed in a cash-basis reporting system, would tend to distort the proper understanding of the transactions.
<p><u>Time horizon</u> Do owner-managers have a time horizon which might be better served by a cash basis than an accrual basis?</p>	20 ;21 ;22 ;23	26; 27; 28	Many owner-managers tend to operate in a shorter term time horizon, focusing on personal and business financial survival. The quest for survival poses a real danger of “overdrawing” with a negative impact on the sustainability of the business operations. A cash-basis

Issues addressed in sub-question, and sub-question (continued)	Question number in accounting practitioner questionnaire (continued)	Question number semi-structured interview (continued)	Conclusions (continued)
<p><u>Financial discipline</u> Does compliance with sophisticated accounting standards contribute materially to the fostering of financial discipline in the target entities?</p>	6	15	<p>system may enhance such a short-term view to the detriment of the enterprise.</p> <p>Accounting records are important for maintaining financial discipline. The emphasis, though, is on basic practices adding value to the day to day decision-making and not on compliance with accounting standards.</p>
<p><u>Simplification</u> Do accounting practitioners support the deviation from a strict accruals basis in the financial statements of owner-managed enterprises?</p>	24; 25; 26	29	<p>Practitioners do support deviation from a strict accruals basis, but are afraid that oversimplification can cause the information to be less useful. This problem may perhaps be resolved by an additional financial statement (more user-friendly than a cash flow statement)</p>

			<p style="text-align: center;">Conclusions (continued)</p> <p>assisting owner-managers in the transition between cash-basis thinking and accrual-basis financial reporting.</p>
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6.4 Final conclusions

What are the financial information needs of owner-managers of owner-managed entities and how are these financial information needs best served through different accounting basis used for the recording and reporting of financial information?

The study has only focused on entities which are not publicly accountable. It has confirmed that grounds for simplification of financial statements, as suggested by the IWG, indeed exist in owner-managed entities, namely:

- Owner-managers, SARS and the bank (and sometimes creditors), as prominent users, often rely on information outside the annual financial statements.
- Limited internal accounting expertise.
- Simplicity of many transactions.

The study has also demonstrated clearly that annual financial statements are only one of many sources of financial decision-making for owner-managers. Owner-managers are intimately aware of cash movements in the entity and therefore they use bank statements very often, because many of them operate in a survival (or serving the current life style) mode. It can be said that owner-managers resolve solvency and liquidity issues on a daily basis. This phenomenon incorrectly creates the impression that they are only interested in cash flow information. Ironically, the statement of cash flow, as component of financial statements, has emerged as the least appreciated by owner-managers. This is partly the case because they do not understand the format (traditionally the indirect method), but also because they associate cash-basis

information with day to day cash management instead of a source of information useful for a strategic reflection.

Although it was clear from interviews that few entities had very knowledgeable internal accounting expertise, owner-managers in general demonstrated some understanding of accrual-basis accounting. They preferred to measure purchases and sales in terms of the activity performed and not cash flow and have a general appreciation of the income statement as an instrument for measuring financial performance. This observation is in line with Page's finding (Page, 1984) that the directors of private companies' see assessment of profitability as the most important use of the financial statements. Furthermore, many owner-managed entities do have transactions (like depreciation) not properly reflected by cash flow, necessitating accrual accounting for proper understanding. Turnover, one of the most appreciated performance indicators of owner-managers, is an accrual-basis measurement.

Owner-managers highly value an annual reflection on financial performance, in some cases with the assistance of accountants. Some describe this as "a behaviour changing experience". Annual financial statements, therefore, are not used often, but are indeed seen as reporting on the outcome of the many decisions taken during the year. Many of these decisions are taken on a cash basis or a needs basis.

Owner-managers prefer accrual-basis financial statements. Many do feel though that there is a need for simplification of annual financial statements. This reflects the spirit of the IWG recommendations, namely that basic accrual accounting is suitable, but that the presentation of financial statements must be rethought to fit the needs of users.

These findings are subject to the limitations explained in 4.3.3 (Delineations of the study), namely:

- the accountants' opinions were based on close corporations only and
- semi-structured interviews were only conducted with entities accessible via their accountants.

7. RECOMMENDATIONS AND FURTHER RESEARCH REQUIRED

7.1 Recommendation

Cash-basis accounting simply does not reflect all materially important transactions, and therefore an accrual system is important in view of the reliance of many owner-managers on the financial statements for an annual reflection to observe the result of decisions taken during the year. The intimate knowledge of owner-managers about the day-to-day business of their entities puts the emphasis away from detailed disclosure (in the spirit of accounting standards) and towards reflection on the big picture of the business to best serve the owner-managers' interest.

Simplification may be a tool to educate owner-managers on the limitations of cash-basis reports regarding issues of strategic importance, such as basing owners' remuneration on profitability and doing budgets considering the impact of previous accruals, by emphasizing the impact of accruals on a cash performance measurement.

In order to prevent simplification to dilute the usefulness of financial statements to outside users of financial statements, it is recommended that simplification take the route of an additional, user-friendly financial statement.

7.2 Further research required

This study did not conclude what the exact nature of such simplification of annual financial statements for qualifying entities should be. Further research could be conducted to test the appropriateness of specific options. Two possible options implied by this study are:

- A one-page supplementary statement focusing on change in total assets and liabilities, income and expenses, and an abridged direct cash flow statement.

- A statement of cash flow, reconciled to an accrual basis, emphasising the impact of specific accruals.

The literature revealed that the cash basis and simple accrual-basis of accounting can provide good quality components of profit. Most of the research on differential reporting is done by means of perception studies, giving evidence of stakeholder preferences based on experience and conventional practice. The cost-benefit of additions to sophistication in accounting basis (and refinement in measurement and recognition criteria) should not be determined by consensus decisions, but should rather be assessed by conceptually based criteria developed by further research.

7.3 Contribution to knowledge

The quest for differential reporting and limited purpose financial statements is well acknowledged in the literature. The general approach, though, is to define differential reporting concessions with reference to a model of full disclosure. This study has demonstrated that owner-managers as users of financial statements do indeed take advantage of their unique position to consult detailed accounting records and other inside information in financial decision-making. Financial statements for owner-manager purposes therefore, should state their main message of financial position and financial performance and change in financial position as simply as possible, but also clearly.

The study therefore calls for a fresh look at the format of presentation of financial statements in the owner-manager environment. Cash flow information, if included, should be presented in a direct format; otherwise it should rather be excluded.

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**THE ROLE OF THE CASH BASIS IN
LIMITED PURPOSE FINANCIAL
REPORTING**

by

Willem Adriaan Lötter

(Continued)

ANNEXURES

ANNEXURE 1

QUESTIONNAIRE TO BE COMPLETED BY PRACTITIONERS

Page 1 of 10

Please answer the following questions pertaining to your close corporation clients.

- 1 How **long** have you been a practising member of CFA (SA)?
(Tick only the applicable box)

Less than one year

One to five years

Longer than five years

- 2 How **many** members does the typical close corporation client have?
(Tick the most applicable box)

One

Two to five

Six to ten

- 3 Are the members of your typical close corporations **active** in the business?
(tick the most applicable box)

All are active.

Most are active.

Few are active.

- 4 Which **journals** of first entry are typically used by your close corporation clients:
(Tick yes or no)

Yes No

Only cash journals/ cash book

cash journals and general journal

a comprehensive set of journals

5 Which of the following **(more advanced) transactions**, do your close corporation clients engage in: **(Please tick the applicable box)**

	Often	Sometimes	Never
foreign exchange	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
leases/ hire purchase	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
revaluation of assets	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
depreciating assets	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
other? (please specify)	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>

6 How good are each of the following practices, in your view, to help **fostering financial discipline** in close corporations: **(Tick the applicable box for each listed practice)**

	Very Good	Good	Bad	Very bad
keeping records to complete VAT returns	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
keeping records to complete annual financial statements	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
compliance to GAAP in the financial statements	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
Another? Please specify below:	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>

7 What, in your view, are the important **sources** of financial information used by owner-managers of close corporations for **taking decisions** in the corporaton.

(Tick the applicable box for each source listed)

	Very important	Important	Less important	Not important
bank statements	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
accounting records (e.g. journals and ledgers)	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
management accounts prepared more than once a year	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
annual financial statements	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
budgets	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
another? Please specify.	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>

8 What **kind of decisions** do you associate with the sources of financial information you have indicated as important above? Distinguish routine (regular) decisions from irregular decisions if applicable.

9 Which of the following financial statements do you typically prepare for your close corporation clients?
(tick only the ones' you typically prepare for them)

balance sheet	<input type="checkbox"/>
income statement	<input type="checkbox"/>
cash flow statement	<input type="checkbox"/>
statement of receipts and payments	<input type="checkbox"/>
statement of changes in net investment of members	<input type="checkbox"/>
another statement (please specify)	<input type="checkbox"/>

10 How **useful, to the owner-managers** of the close corporation, do you rate the financial statements (indicated in the previous question)?

(Tick the applicable box for only the financial statements typically prepared)

	Very useful	Useful	Less useful	Not useful
balance sheet	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
income statement	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
cash flow statement	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
statement of receipts and payments	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
statement of changes in net investment of members	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
another statement (please specify)	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>

11 Do you regard financial statements of close corporations in their **current format** as:

(Tick yes or no)

	Yes	No
simple enough to be properly understood by owner-managers	<input type="checkbox"/>	<input type="checkbox"/>
user friendly	<input type="checkbox"/>	<input type="checkbox"/>
useful for management purposes	<input type="checkbox"/>	<input type="checkbox"/>

12 Are there certain obvious aspects of financial statements which, in your view, do not consider the specific needs of smaller businesses (eg terminology used etc.)?

13 Who, in your experience, are the users of the annual financial statements of close corporations?
(Tick only the ones which apply to your clients corporation)

the owner-managers	<input type="checkbox"/>
the bank	<input type="checkbox"/>
suppliers (creditors)	<input type="checkbox"/>
SARS	<input type="checkbox"/>
Another party? Please specify below:	<input type="checkbox"/>

14 To what extent, in your view, do the **users** (which you specified above) find the financial statements of the corporation **useful** in their **current format**?

(Tick the applicable box for each listed user of financial statements)

	Very useful	Useful	Less useful	Not useful
the owner-managers	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
the bank	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
suppliers (creditors)	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
SARS	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
Another party? Please specify below:	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>

15 Do you **think** the financial statements of close corporations are used for the following purposes:
(Tick the applicable box for each listed use of financial statements)

	Often	Some- times	Seldom	Never
to make investment decisions	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
as a planning document eg. as a basis for future budgets	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
to make financing decisions	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
to determine the affordability of owner(s) remuneration	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
Another purpose? Please specify:	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>

16 Elaborate about the type of decision actually made using financial statements.

17 How are the following **indicators of financial performance** rated by owner-managers in your view?

(Tick the applicable box for only the indicators which you deem to be applicable)

	Very Good	Good	Bad	Very bad
turnover/ sales	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
the bank balance	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
profit (or loss) per income statement	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
a cash surplus (or deficit)	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
another financial performance indicator? Please specify below:	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>

18 How often, in your view, do owner-managers actually use the indicators of financial performance (as rated above).

19 If you indicated before that cash surplus (or deficit) figures and/or profit (or loss) figures are valued as indicators of financial performance; indicate how useful you regard each of the following types of surplus (deficit) and profit (loss) figures.

	Very useful	Useful	Less useful	Not useful
a cash surplus resulting from all cash receipts less all payments	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
a cash surplus resulting from cash receipts of operating nature less payments of operating nature	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
cash generated from operations per cash flow statement	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
profit determined according to tax legislation	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
profit determined according to GAAP	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
another version of cash surplus (deficit) or profit (loss)? Please specify.	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>

20 How important is it, in your view, is it that financial statements confirm the ability of the business to afford the **owners' remuneration** (salaries, interest on capital, member's salaries etc.)?
(Tick only the applicable box)

Very important	Important	Less important	Not important
<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>

21 Do you think existing financial statements can be clearer on this aspect?

22 Which one of the listed three financial values are mostly nurtured by the owner/managers of close corporations in your view?
(Tick only one of the three)

- survival of the corporation
- to support the current lifestyle of the owner(s)
- to grow financially (beyond the needs of the owner(s))

23 Which other values (not necessarily financial) values are nurtured by owner-managers of close corporations in your view?

- stability of the corporation
- autonomy of the corporation (independence)
- Other values? Please specify below:

24 If you had a free hand to **redesign the financial statements** of close corporations from scratch, to what extent would you **support** the following **suggested changes**?
(Tick the applicable box for each suggestion listed)

The financial statements should:

	Fully support	Support	Some support	No support
reflect only cash transactions	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
predominantly reflect cash transactions, but also selected accruals (eg. providing for tax payable)	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
reflect tax values as far as possible	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
be in full compliance with GAAP	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
reflect only GAAP, appropriate to the corporation	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
restrict complicated transactions to notes	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
Another suggestion? Please specify below.	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>

25 Elaborate on the aspects of financial statements in which you support change.

26 Do you think it is necessary to simplify financial statements for smaller businesses at all? Motivate.

27 Are the financial statements of your close corporation clients **audited**?
 (Tick only the applicable box)

Annually	Some- times	Never
<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>

28 To what extent, in your view, would the following possible **benefits of an annual audit** apply to this corporation ?
 (Tick the applicable box for each listed possible benefit)

	Very applicable	Applicable	Less applicable	Not applicable
Fraud detection	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>

to make financial statements more credible for outsiders	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
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Any comment in this regard?

29 How important, in your view, is an unqualified audit report?
(Tick only the applicable box)

Very Important Less Not
important important important

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Please motivate your choice

30 Would you like feedback on the analysis of this questionnaire?
(Tick only the applicable box)

Yes

No

If yes, please supply some or all of the following information:

Name

e-Mail address

Telephone

ANNEXURE 2
Analysis of practitioners' questionnaire

Median

1 How long have you been a practising member of CPA (SA)?
 (Tick only the applicable box)

	n	%
Less than one year	16	7%
One to five years	58	24%
Longer than five years	<input type="text" value="167"/>	<input type="text" value="69%"/>
	<u><u>241</u></u>	<u><u>100%</u></u>

2 How many members does the typical close corporation client have?
 (Tick the most applicable box)

	n	%
One	46	19%
Two to five	<input type="text" value="186"/>	<input type="text" value="78%"/>
Six to ten	8	3%
	<u><u>240</u></u>	<u><u>100%</u></u>

3 Are the members of your typical close corporations **active** in the business?
(tick the most applicable box)

	n	%
All are active.	106	44%
Most are active.	<input type="text" value="126"/>	<input type="text" value="52%"/>
Few are active.	9	4%
	<u>241</u>	<u>100%</u>

4 Which **journals** of first entry are typically used by your close corporation clients:
(Tick yes or no)

	n	%
Only cash journals/ cash book	127	38%
cash journals and general journal	<input type="text" value="128"/>	<input type="text" value="38%"/>
a comprehensive set of journals	81	24%
	<u>336</u>	<u>100%</u>

5 Which of the following (more advanced) transactions, do your close corporation clients engage in: (Please tick the applicable box)

		Often 3	Sometimes 2	Never 1	Total	Mean	Mode	Median	Ranking
foreign exchange	n	12	122	92	226	1.6	2	2	4
	%	5%	54%	41%	100%				
leases/ hire purchase	n	154	77	4	235	2.6	3	3	2
	%	66%	33%	2%	100%				
revaluation of assets	n	26	149	53	228	1.9	2	2	3
	%	11%	65%	23%	100%				
depreciating assets	n	204	23	7	234	2.8	3	3	1
	%	87%	10%	3%	100%				
other? (please specify)	n	3	7	8	18				
	%	17%	39%	44%	100%				Not significant number of responses

- CGT
- Revaluations
- Joint ventures
- Property
- Derivatives
- Inventory valuation

6 How good are each of the following practices, in your view, to help fostering financial discipline in close corporations: **(Tick the applicable box for each listed practice)**

		Very Good	Good	Bad	Very bad	Total	Mean	Mode	Median	Ranking
keeping records to complete VAT returns	n	4	3	2	1	233	3.5	4	4	1
	%	125	102	5	1	233				
		54%	44%	2%	0%	100%				
keeping records to complete annual financial statements	n	99	125	10	1	235	3.4	3	3	2
	%	42%	53%	4%	0%	100%				
compliance to GAAP in the financial statements	n	53	131	40	6	230	3.0	3	3	3
	%	23%	57%	17%	3%	100%				
Another? Please specify below:	n	5	4	2	0	11				Not significant number
	%	45%	36%	18%	0%	100%				of responses

Any other financial regulations eg. GAMAP, PMFA, MFMA, etc. (1)

Salary and PAYE records (1)

Monitoring Cash flow (4)

To drive cash flow and doing projections (3)

Trained staff in place (1)

7 What, in your view, are the important sources of financial information used by owner-managers of close corporations for taking decisions in the corporaton. (Tick the applicable box for each source listed)

	Very important				Less important		Not important		Mean	Mode	Median	Ranking
	4	3	2	1								
	n	%	n	%	n	%	n	%				
bank statements	142	59%	72	30%	23	10%	4	2%	3.5	4	4	1
accounting records (e.g. journals and ledgers)	68	29%	90	38%	68	29%	11	5%	2.9	3	3	3
management accounts prepared more than once a year	99	41%	91	38%	41	17%	8	3%	3.2	4	4	2
annual financial statements	97	40%	90	37%	50	21%	4	2%	3.2	4	4	2
budgets	77	32%	85	35%	55	23%	23	10%	2.9	3	3	3
another? Please specify.	12	75%	3	19%	1	6%	0	0%	Not significant number of responses			

- Cash flow (6)
- Daily press (1)
- Accounting officers advise (1)
- Industry knowledge (1)
- Annual advance planning, Adherence to prescriptions own labour from government legislation (3)
- Chequebook counterfoil (1)
- Daily Sales Trends (1)
- Gut feel (1)
- Knowing your client base anticipating change that can impact on the business (1).

8 What **kind of decisions** do you associate with the sources of financial information you have indicated as important above? Distinguish routine (regular) decisions from irregular decisions if applicable.

Respondent Responses

- 1 Finance approval
- 3 Purchasing capital assets/expansion activities/budget preparation
- 3 Expansion activities
- 3 Budget preparation
- 4 Taxation to be assessed
- 4 Valuation
- 9 Buy / sell of entity
- 10 Predictability of future success of business/Correct running of daily activities
- 10 Correct running of daily activities
- 11 Cash flow management
- 16 Projected cash flows (irregular)
- 18 Inventory purchases
- 19 Salary and bonus decisions
- 26 Members loan account maintenance
- 43 Employing Staff/ Advertising/ Marketing/ Going on holiday - where, when, how long
- 43 Advertising and Marketing
- 43 Planning personal expenditure
- 53 Price increases
- 53 Debt collection
- 53 Internal control
- 54 Variance analysis
- 55 Tax planning
- 56 Seasonal business cash flow planning
- 85 Determines if entity still a going concern
- 86 Distribution decisions
- 89 **ROUTINE** - creditor payment timing; add stock
IRREGULAR - Expansion; capital purchases
- 117 Industry knowledge and "know how" often considered more important factors than financial issues.
- 149 Verification of corruption, irregularity, Financial Stability
- 150 Bank statement - quick check to whether written up accounts agree-quick check to comparison times/
Accounting records some owner-managers don't understand the financial accounts/About 80% of my businesses (clients) do their own budgets.
- 151 Owner/manager - know when to expand business. (look at cash flow)

- 152 Financing decisions
- 153 **Regular** - Bank Statements, Chequebook counterfoils, **Irregular** - Accounting Records, Management Accounts, Annual Financial Statements, Budgets. Page 7
- 156 Cash flow problems, Liquidity, Profitability, Evaluation.
- 157 That keep a clear record of your books you will get the true picture of business performance.
- 158 Cash flow, Profitability, Monthly Management accounts used in decision to close poorly performing business.
- 159 **Regular decisions** - Paying creditors, **Irregular decisions** - Buying/financing assets.
- 160 Expansion of business activities, Peace of mind that the business will continue to grow, Financial Security.
- 161 **Bank Statements** - pricing, costing, strategy, Financing. Daily Sales Trends - Procurement decisions, Growth planning, Infrastructure needs- Equipment, Delivery vehicles, staff.
- 162 Cash flow projections, Capital structure.
- 163 Capital budgeting - ie Purchasing machinery.
- 169 Cash flow management - **bank statements**, Accounting records used for medium to long term planning.
- 170 To buy the business
- 173 Cash flows, Tax liability, Growth, Investment Decisions
- 175 Stock levels, Profit, Spending
- 178 Accounting Records - Tax liability/monitoring accounting system, Management accounts - up to date, planning target meeting, Financial statements - Profitability, solvability, Budgets - sustainability.
- 179 Future growth - Irregular, Improve Cashflow - Regular
- 181 Sales targets, Outstanding debtors
- 183 Movements in cashflow clarification for purposes of acquiring finance in respect of assets or for bridging finance.
- 185 Management decisions
- 186 Purchase of fixed assets
- 187 Management of working capital
- 188 To finance an asset
- 189 Further investment, Growing of business, Financing
- 190 Buy/sell, expand, branching into other segments.
- 191 Die stel van finansiële state vir gebruik van besluitings met beleggings en/of belasting implikasies by besluitneming.
- 192 Monitoring turnover on overheads, Analysing the growth of the business.
- 194 Regular decisions - Expanding business, Cash flow, Tax purposes, Loans
- 195 Financing, Buying of new assets, Additional accounts and payment methods.
- 196 **Regular** - Cash flow decisions, Projections, Accuracy of Accounting, **Irregular** - New loans, New Partners, Overdraft facilities.
- 200 Depending on the stability of the entity and the cash flow strength: **Regular decisions** - Daily cash decisions are determined . using reconciled bank statements. - Productivity (throughout) as sales as collections from the monthly/weekly **management reports**. - Debtors outstanding and aging determine collection. - Financial performance as targets and activities related. **Irregular decisions** - Adaptations to strategy - Comparison to budgets to certain spending or review expense allocations. - Performance of certain departments.

- 201 Business expansion/Strategy to enhance profitability/Financing of assets (ie on or off balance sheet)/Liability of continuing business into the future/Valuation of business for purposes of taking in/buying out partners.
- 202 **Bank statements** give view of cash flow of business/**Management accounts** give view of profitability of business.
- 203 Verstaan nie die vraag nie
- 204 New purchase of assets, The need to acquire financial assistance for expansions/Employing, keeping or retiring employees.
- 206 **Regular** decisions - Purchasing of new assets, Vehicles, etc on finances, Cash Flow, Affordability
- 208 Mostly clients **do not ask for help or information** before making decisions
- 209 **Bank Statements** - reasonableness testing of income/**Records** - Compliance of the business and likelihood of having reliable statements/**Management A/c's** - progress reporting on regular basis/ AFS - profitability and growth in any given period/**Budgets** - To control spending and future planning.
- 210 Funding in place to grow business
- 211 Used in determining the potential of the growing business and future growth prospects
- 212 **Bank Statements** in respect of coreciness and cash flow management/ **Accounting records** - No informed can be made unless it is based on complete accounting records ie. Is the fixed cost or variable cost element correct.
- . Can another long or short term expense be justified/Management accounts are critically important for a good manager
iro decision making/ **Annual financial statements** only required for SARS/ Banks iro finance/**Budget** - cash is extremely important for planning.
- 213 **Bank Statements** for Cashflow management/**Accounting records** to help you prepare the management account on a regular basis/**Budget** to track performance of your business and take necessary steps in any situation/**Annual Statement** for the overall performance.
- 218 Cash Flows, Budgets, etc/Solvency Ratios
- 219 **Irregular:** Identify losses early in a year, Management to decide to diversify products, change input cost or even decide to cease rading if losses can not be corrected.
- 220 Investment, Cash flow
- 227 Expansion of business/Cash flow requirements
- 231 Profitability, Capital Budgets, Cashflow
- 239 The current liquidity/Income for the year
- 241 Cash flow/Growth/Profit/Loss/Assets/Debtors/Creditors/Loans

- 19 The bank statement is often the small/medium owner's main financial source of information. If there is money in the bank or the balance is growing positively purchases and expansions can be done. If bank balance is going the negative way it is perceived that the business is not profitable.
- 66 Bank statement give owner assurance
- 68 Bank statement shows funds available for payment.
- 71 Only wants to know if money in the bank and if they can pay accounts.
- 91 Clients work on bank statements alone; accountant consulted for other decisions
- 102 My clients are very small and it is scary to see how many of them just rely on their bank balance. Basically they only have to decide on whether to purchase new assets and how to finance the transaction.
- 109 Specific needs necessitates a particular stance on decision making. Members of CC's really first intensify a want, then decide as to why it is needed and then they justify and motivate it ostensibly with a view to have it financed.
- 135 Do I have enough cash to buy a new BMW?
- 136 I expected to make a profit and have cash in the bank - Why am I not?/The bank is going to call for my financial results - am I going to be close to what I advised them I would do when I submitted my application for overdraft?
- 147 Bank statements - indicate to the owners the validity of the entries in the statements in order to query any discrepancies timeously (most important) monthly

9 Which of the following financial statements do you typically prepare for your close corporation clients?
(tick only the ones' you typically prepare for them)

	Do prepare	Do prepare
	n	%
balance sheet	240	100%
income statement	240	100%
cash flow statement	200	83%
statement of receipts and payments	62	26%
statement of changes in net investment of members	163	68%
another statement (please specify)	37	15%
	<u>240</u>	

10 How **useful, to the owner-managers** of the close corporation, do you rate the financial statements (indicated in the previous question)

(Tick the applicable box for only the financial statements typically prepared)

	Very useful 4	Useful 3	Less useful 2	Not useful 1	Total	Mean	Mode	Median	Ranking
balance sheet	n 87 36%	122 51%	30 13%	1 0%	240 100%	3.2	3	3	2
income statement	n 153 64%	80 34%	5 2%	0 0%	238 100%	3.6	4	4	1
cash flow statement	n 72 32%	59 27%	62 28%	29 13%	222 100%	2.8	4	3	3
statement of receipts and payments	n 29 19%	46 30%	49 32%	29 19%	153 100%	2.5	2	3	4
statement of changes in net investment of members	n 21 11%	41 21%	84 43%	50 26%	196 100%	2.2	2	2	5
another statement (please specify)	n 18 49%	8 22%	7 19%	4 11%	37 100%	Not significant number of responses			
Budget (2)									
Taxation									
Cash flow									
Asset register									
Change in equity									
Cash Flow Budget									
Explaining the amount drawn for members use.									
<u><u>1 086</u></u>									

11 Do you regard financial statements of close corporations in their **current format** as:
(Tick yes or no)

		Yes	No	Total
simple enough to be properly understood by owner-managers	n	186	53	239
	%	78%	22%	100%
user friendly	n	182	55	237
	%	77%	23%	100%
useful for management purposes	n	161	75	236
	%	68%	32%	100%

12 Are there certain obvious aspects of financial statements which, in your view, do not consider the specific needs of smaller businesses (eg terminology used etc.)?

Respondent (Cash related comments bold)

- 1 Cash flow statement evident from income statement
- 4 Terminology
- 9 Some clients do not understand the AFS
- 10 No
- 11 Cash flow statement evident from income statement
- 12 The funding by way of loan accounts
- 13 No
- 15 No
- 19 **The cash flow statement is seldom understood.** Balance sheets are often viewed with a blank look as to why it is there.
(A question I have often heard is what does the totals on a Balance sheet mean)
- 20 Terminology used/ **format of Cash flow statement**
- 25 **The understanding of cash flow statements** is a priority
- 26 No
- 29 Yes, it is historical and are required by 3rd parties, for whom additional forms still need to be completed
- 36 No
- 39 No
- 44 Financial Statements are not understood by the average CC member. **That is our duty to explain them.**
- 45 Terminology used/Layout differs from one practitioner to another/Some notes meaningless.
- 49 No
- 52 **Cash flow statement should be more detailed**
- 54 Rather encourage financial literacy
- 55 Apply big GAAP selectively
- 59 **Cash flow statement; certain notes eg. Deferred tax**
- 66 Terminology
- 71 **Cash flow statement to difficult to understand; rather source and apps**
- 73 **Cash flow terminology.**
- 77 **Cash flow statements not user friendly**
- 78 **Terminology need to be generic.**
- 84 Treatment of deferred finance charges
- 85 **?????????//**
- 86 Members net investment statement useless

- 90 Terms like PPE do not apply to small business; why use.
- 91 ????????????
- 94 Training will prevent this understanding gap.

- 95 **Cash flow**
- 96 More about ratios, which can be useful if understood by small business owner.
- 101 **Cash Flow statement**
- 103 Some terminology could be simplified for the "one man band" closed corporations, they don't always understand.
- 105 Terminology is a problem
- 106 Historical and not usually relevant to current trading.
- 107 No
- 108 Absurd
- 109 Accounting Policies must become much more understandable to members and its reasons must be studied more obviously.
Well motivated accounting policies being about greater understanding.
- 112 **Cash flow statement in AFS**
- 113 **Cash flow and statement of investment**
- 116 Most of the SME owners don't know the difference between balance sheet and income statement items, thus they do not know how to use the financial statement. They only get it sorted for tax/overdraft purposes.
- 122 Overall fair - I explain to owner/management what it means and consequences.
- 123 the user does not always understand the terminology of the financial.
- 125 Yes, all too technical
- 130 Kliente raak verward met te veel detail in notas.
- 131 The balance sheet should be a more detailed statement that does not refer to notes. All the information should be on the one page if possible. This would make it easier to read.
- 132 No
- 135 IA's history by the time the clients get it/IA's does not anticipate the future.
- 136 The notes to the accounts should deal with practical aspects such as out of line items and comparison with "normal" expectations.
- 137 No
- 140 All the disclosure
- 147 No
- 149 Accounting Policy
- 150 **Terminology** - big problem, the client don't understand what you are talking about.
- 156 No
- 157 The **terminology** used, I think it's better if its limited to where it is right now nothing should be added what can be done is to try and simplify other aspects.
- 160 No
- 165 Terminology, **also format** of statements

- 169 No **terminology can be explained.**
- 170 Most of them don't understand financial statements and therefore **must be set out as simple as possible** for them to understand it.
- 173 Compliance with GAAP
- 175 **Cash basis statements are better understood.**
- 176 Difficult for average businessman to read and understand without knowledge of accounting.
- 178 Cashflow statement
- 181 No
- 185 Don't know
- 191 **Kontanvloei in huidige vorm - Meeste eienaars en/of banke verstaan dit nie.**
- 192 Many smaller businesses do not understand the terminology and ratio etc. However **when the accountant explains it**, it easier as the terminology is appropriate.
- 193 Cash flow - **format not easy enough** for owner to interpret.
- 194 No
- 200 Not in my experience - the financial statement should be understood and should be appropriately reviewed with the client.
- 206 **Cash flow statements not easily understood** by the owner/manager of business.
- 208 They should perhaps include simple ratio analysis and devise as to whether or not they are going well.
- 209 No
- 211 Inconsistent terminology, inconsistent layout
- 212 GAAP too complicated
- 214 Payables, my clients understand creditors that is they must pay up.
- 217 **Cashflow statement**
- 230 **Layout/wording/Cashflow too complicated and meaningless**
- 231 Ratios and explanation there of.
- 236 None
- 239 No
- 241 Every item is useful

13 Who, in your experience, are the users of the annual financial statements of close corporations?
(Tick only the ones' which apply to your clients corporation)

	n	%	Ranking		Total	Mean	Mode	Median	Ranking
the owner-managers	194	82%	3						
the bank	238	100%	1						
suppliers (creditors)	54	23%	4						
SARS	236	99%	2						
Another party? Please specify below:	21	9%							

238 / 100%

14 To what extent, in your view, do the users (which you specified above) find the financial statements of the corporation useful in their current format:

(Tick the applicable box for each listed user of financial statements)

	n	%	Very useful	Useful	Less useful	Not useful	Total	Mean	Mode	Median	Ranking
			4	3	2	1					
the owner-managers	67	30%	111	49%	40	8	226	3.0	3	3	3
					18%	4%	100%				
the bank	102	44%	118	51%	11	1	232	3.4	3	3	2
					5%	0%	100%				
suppliers (creditors)	19	15%	48	37%	38	26	131	2.5	3	3	4
					29%	20%	100%				
SARS	124	54%	92	40%	11	2	229	3.5	4	4	1
					5%	1%	100%				
Another party? Please specify below:	14	52%	11	41%	2	0	27				
					7%	0%	100%				

Not significant number of responses

Prospective buyers (9)
Liquidators
Staff
Auditors
Big Companies
Donars

15 Do you **think** the financial statements of close corporations are used for the following purposes:
(Tick the applicable box for each listed use of financial statements)

	Often	Some- times	Seldom	Never	Total	Mean	Mode	Median	Ranking
to make investment decisions	4 n 67 29%	3 112 48%	2 48 21%	1 5 2%	232 100%	3.0	3	3	4
as a planning document eg. as a basis for future budgets	4 n 90 38%	3 102 44%	2 34 15%	1 8 3%	234 100%	3.2	3	3	2
to make financing decisions	4 n 109 46%	3 99 42%	2 26 11%	1 2 1%	236 100%	3.3	4	3	1
to determine the affordability of owner(s) remuneration	4 n 84 37%	3 86 38%	2 45 20%	1 13 6%	228 100%	3.1	3	3	3

Another purpose? Please specify:

Income tax purpose (5)
Tax plan
To obtain investors
Finance
Borrowings (2)
Sales/Purchases
VAT

n	12	2	1	0	15	3.1	3	3	3
%	80%	13%	7%	0%	100%	Not significant	Not significant	Not significant	number of responses

Respondent (First time mention- bold)

- 2 Future **financial planning** of business to see what prospects lie ahead.....
- 5 **Taxation / acquisition of assets**
- 6 Determining future growth to raise further capital. To secure or request for **increased credit facility**.
- 7 Determine Tax liability
- 9 Funding criterion
- 11 Financing/lending
- 13 Management decisions, **Tax planning**, Financing decisions, Investment decisions, Expansion decisions
- 15 Investments
- 16 Is die besigheid **Likied**
- 19 What tax has to be paid. Is the business **solvent**
- 24 If you want to expand Business
- 26 Profit or loss

- 29 Taxation position and how to improve on it/ **Budgets** for the new year on obvious problem items
- 30 **Cash flow decisions** / Financing decisions
- 42 When the client wants a loan from the bank
- 43 **This was answered under 8 - answer is similar Question is ambiguous**
- 44 For SARS and **statutory purposes**/They are **not useful for planning** etc as only prepared annually and usually many months after the year end.
- 46 Mainly used for profitability and **value of owners equity**
- 47 Leen van **fonse/Uitbreiding**
- 49 Annual Taxation/ Short and long term financing by the bank
- 52 Bank interested in **solvability**
- 53 **Profitsharing of employees**
- 55 Tax planning and financing
- 59 Will the bank lend money to firm; tax obligation; **members loan account**
- 65 Financing via bank/ **sell or buy business**
- 66 **Owners decide irrespective of FS**
- 71 Financing/ future growth
- 72 Tax liability

- 74 Comparisons among years (ratios+results)
- 76 To obtain finance
- 81 Financing/ expansion
- 90 Mostly strategic decisions; **often AFS not even consulted**
- 92 Bank finance+tax returns
- 93 Tax\
- 94 Budgets/ value of business/ **dividends**
- 95 Financing
- 97 **Going concern?**
- 102 **Most of the members only look at the financial statements when we discuss it and never again. They only use it for their overdrafts, loans and SARS.**
- 107 As above
- 108 Continuity profitability, expansion of business
- 113 Tax savings, Financing
- 115 Apart from bank statement it's a **summary of historical events to formulate a strategy.**
- 118 **See 8**
- 122 New enterprise or expansions in/ Policy and strategic changes or evaluations.
- 124 **Affordability etc, Cash flow**
- 125 **None by owner**
- 127 Bank needs information for financing and overdraft financing. Application for credit with suppliers
- 130 Verstaan nie die vraag nie.
- 131 **To liquidate the company/** To raise a bank loan
- 132 For any other purposes as long as it is for finance decision
- 135 Tax planning
- 136 Salaries of staff/Replacement of fixed assets - what will it cost me?**/Where can I make savings to be able to make a profit.**
- 140 Profit or loss/Continuity/sustainability
- 141 Financing of new assets, Declaration of dividends - decide amount
- 143 The planning and business decisions.
- 146 Determine tax liability
- 149 To ascertain whether the corporate is on going concern.
- 150 Some Close Corporations just to get rid of all the legalities.
- 152 Profitability
- 156 For loan or overdraft purposes
- 157 Financial statements can be used to **suit individual specific needs.**
- 158 Prior year financial statements are often used as a **basis when preparing the budget** for the following year. (most clients don't

- do a budget though) Fin Statement used when working out members remuneration.
 Refer to 8
- 159** Selling, Purchasing a business, Planning a strategy to better a CC's nett asset position.
161 Very few - dividends/**distributions to owners**.
165 Small business owners have access to information throughout the year and use this info in making a lot of financial decisions.
169
- One cannot wait for the AFS before making decisions as this is historical info only.**
- 175** Members remuneration, Tax payable.
183 Bottom line - tax liability and profitability, Approval of finance.
184 Future of business, financing of LTL
185 As hinted above, with regard to financing decisions mostly. Is gearing, stock levels debtors in financials used to determine financing needs.
190 Selling of business
191 Winsgewendheid/ stiling van besigheid/belasting implikasies
192 Loss of expanding the business/ Expenses and the effect thereof.
195 Has expected growth taken place to ensure appropriate profitability? What can be done to improve if not?
197 **Viability of the business. Breakdown of expenditure incurred.**
200 Financial statements are seen as a formality by most of the users, management accounts are used by owners for decisions financing decisions are made by outside insitutions.
201 Profitability of the business/Ability to finance expenditure
202 Members wishing to sell or take over on new members will take AFS to formulate a price/**Members remuneration must be in line with profitability of business** as shown in AFS.
205 Results and financial position for/at same time
208 My clients don't seem to care about their AF's (wholly) they just want them for SARS to be happy (ie to submit tax returns)
209 To establish the tax liabilities due and funding possibilities.
210 Viability of the business, Profitability, Sustainability
211 Viability, profitability, sustainability, great potential
212 The fact that it is an **annualised set gives an overall perspective** if management statements do not include this.
213 Financing the business
214 **Remuneration is usually finalised after AFS** has been completed.
217 Is the close corporation profitable
218 **How to invest excess cash/** How to plan for next years/Determine best ways to reward owners
219 Can the business afford to buy us rent premises and other assets.
226 Tax liability
230 Bank facilities and overdrafts, Financing of assets

233 To acquire assets

235 Tax

238 Was dit nie vir belastingwette sal meeste lede einaars nie eers finansiële state verlang het nie, behalwe om sy oortrekke fasiliteit te woon.

239 Bankers use it/Owners normally know how well their business is doing

241 See 8 above

17 How are the following **indicators of financial performance** rated by owner-managers in your view?

(Tick the applicable box for only the indicators which you deem to be applicable)

	Very Good	Good	Bad	Very bad	Total	Mean	Mode	Median	Ranking
turnover/ sales	n 4	157 66%	3 77 32%	2 2 1%	237 100%	3.6	4	4	1
the bank balance	n 125	54%	103 44%	4 2%	233 100%	3.5	4	4	2
profit (or loss) per income statement	n 101	43%	120 51%	15 6%	236 100%	3.4	3	3	3
a cash surplus (or deficit)	n 101	45%	101 45%	22 10%	226 100%	3.3	3	3	4

another financial performance indicator? Please specify below:

Financial key ratios (3)

Gross profit (5)

Members monies

Gross profit % (6)

Not significant number of responses

Market share

Net Profit before tax/ Tax ratio

Tax payable (2)

Integrity of staff.

18 How often, in your view, do owner-managers actually use the indicators of financial performance (as rated above).

Respondent Responses (More informative ones' bold)

- 1 Sometimes
- 2 Often, especially the financial ratios
- 3 Seldom; especially if they do not understand AFS in the first place.
- 4 Very seldom; they do not understand
- 5 Monthly.
- 6 Frequently
- 7 Only when asked by bank or funders
- 8 **Varies very much**
- 9 Sometimes to look at cash flow decisions
- 11 Daily
- 12 Seldom
- 13 In 50% cases
- 15 6 x per year
- 16 **Cash surplus/Bank Balance/Daily/ Weekly/Turnover - Monthly/P&C per financial statement**
- 18 Sometimes
- 19 **Most business is sales driven/Bank balance cash flow is monitored on short periods.**
- 20 once or twice per year
- 21 Not very often
- 23 Not often enough
- 24 When they want to expand their business
- 25 Depending on the type of business. Eg Buy or sell operations - often/ Property - less often
- 26 Not often
- 29 Once a year
- 30 Seldom - mainly look at what they can afford - **cash flow wise**
- 33 Baie selde, gewoonlijk net wanneer probleme ondervind word.
- 35 Maybe 2 or 3 times a year
- 36 Very Often
- 37 Monthly and quarterly
- 39 Very often - monthly

- 40 **Look daily at bank balance**
- 41 Often
- 42 Seldom
- 43 Monthly or some instances quarterly. Larger ones do this monthly/weekly
- 44 Not often
- 45 Seldom not often
- 46 Twice a year
- 47 2 maal per jaar
- 48 Baie selde
- 49 Mostly once a year/ AFS are monthly used for annual tax and financing
- 50 Not often
- 51 Once a year
- 52 Monthly.
- 53 Often
- 54 Often
- 57 When needed
- 58 Monthly man accounts more useful than AFS
- 59 Very often
- 60 As often as statements are available
- 62 Bank +cash surplus very often
- 63 **Sales monthly; bank daily; profit bi annually; cash surplus often**
- 65 Monthly; some even weekly
- 66 Seldom
- 67 Very seldom; they do not understand
- 68 Monthly
- 69 **Seldom; they will buy as long as they feel they can afford it**
- 70 Seldom
- 71 Small businesses use own discription
- 72 Seldom
- 75 Once a year
- 76 Once a year
- 77 **Depends on the type of business; could be monthly**
- 78 Monthly
- 79 Not regular
- 81 Regularly used

- 82 Regularly used
- 83 Bank regularly; often
- 84 Regularly
- 86 Not all that often
- 87 Some daily; some monthly
- 88 Once a month
- 90 Practitioners advise owners based on AFS
- 91 Annually
- 92 Turnover and cash flow often
- 93 Annually
- 95 Often
- 96 Monthly
- 97 Not often enough
- 99 Very often
- 101 Often
- 102 5% of the time
- 103 It really depends on the owner - manager and the interests to the financial performance indicators.
- 105 At least once a year, possible every month in clients who have overdraft facilities
- 106 Sometimes
- 107 Not often enough
- 108 When making financial decisions
- 112 Mostly one a year. But client who is more actively involved in expanding their businesses and profitability 3 to 4 times per annum.
- 113 Depends on business activity - Once or twice P.A
- 114 Not so often
- 115 Once a year
- 118 Most of the time
- 119 Often
- 120 Not often, only use when applying for financing or want to sell business.
- 122 Only when I work with them or explain the same.
- 123 Very seldom
- 124 Once a month or per annum
- 125 Seldom
- 127 As needed by each client from time to time.
- 130 Onbekend

- 131 Monthly
- 132 Monthly basis
- 133 Never

- 134 Often
- 136 Often, but not necessarily from the AFS.
- 137 Often
- 138 Often
- 139 Maybe 20%
- 140 Seldom
- 141 Not often
- 143 Mostly Bi-monthly
- 146 Seldom
- 147 Quite often for the specified indicators.
- 148 Monthly
- 149 All the time
- 150 **Sales/turnover - always/Bank Balance - regularly/Profit (the figure became available too late for them to worry about. Taxable amount - always aware of.**
- 151 Annually
- 152 Not often
- 153 Many times
- 155 Monthly
- 156 Very often
- 157 Always
- 158 **Always interested in a few basic ratio's specifically GP%, NP, Profit/Turnover**
- 159 Not that often
- 160 Seldom
- 161 **Sales all the time, Bank Balance - quarterly.**
- 162 Most of the time especially only when budgeting.
- 164 Very Seldom
- 165 Only in making occasional financial decisions.
- 166 Not often
- 169 Not as often as they should
- 170 Most of the time every month

- 172 **Only use it for distribution purposes once a year.**
- 173 Monthly
- 174 Never
- 175 Daily
- 176 Seldom

- 178 Reasonably often
- 181 Once a year
- 182 Occasionally
- 183 Quite often in respect of financial overview and profitability and cash generated ability.
- 185 Often
- 186 Maybe not enough
- 188 Seldom
- 190 On a monthly basis
- 191 Gereeld
- 192 Very often in conjunction with the accountant.
- 194 Not often
- 195 On a monthly basis
- 196 **Bank balance cash surplus: once a week, Profit per income statement: four times a year sales: once a month.**
- 199 Redelik gereeld
- 200 Only upon presentation of the financial statements.
- 201 Quarterly
- 202 Annually unless results needed for a specific project.
- 203 Never
- 204 Seldom
- 205 **Bi-monthly for VAT purposes**
- 207 Yearly
- 208 Not often
- 209 Very seldom **only when** it becomes necessary that they are **obliged to consider the contents of the AFS/Financials.**
- 210 Often
- 211 Sometimes, but more often
- 212 Always
- 213 The **bank balance** is looked at on a **daily** basis but others not.
- 214 Bank Balance very often. Turnover sales details are required fairly often.

- 215 Once a year
- 217 Once a year
- 218 Twice yearly
- 219 Most of the time
- 222 Very often
- 226 Seldom, not trained to read the documents
- 227 Whenever the need arises

- 230 Once a year
- 231 quite often
- 232 Twice a year
- 233 Twice a year
- 236 Seldom
- 239 **Owners generally however "know" their business. They decide on their needs normally have made their decision before they they contact the accountant.**
- 241 End of year or appropriate need eg LOAN

19 If you indicated before that cash surplus (or deficit) figures and/or profit (or loss) figures are valued as indicators of financial performance; indicate how useful you regard each of the following types of surplus (deficit) and profit (loss) figures.

	Very useful	Useful	Less useful	Not useful	Total	Mean	Mode	Median	Ranking
a cash surplus resulting from all cash receipts less all payments	n 44% 4	<input type="text" value="95"/> 44% 3	22 10% 2	4 2% 1	218 100%	3.3	4	3	1
a cash surplus resulting from cash receipts of operating nature less payments of operating nature	n 36% 76	<input type="text" value="96"/> 46% 96	32 15% 32	6 3% 6	210 100%	3.2	3	3	2
cash generated from operations per cash flow statement	n 25% 52	<input type="text" value="78"/> 37% 78	60 29% 60	19 9% 19	209 100%	2.8	3	3	4
profit determined according to tax legislation	n 29% 62	<input type="text" value="90"/> 42% 90	46 21% 46	17 8% 17	215 100%	2.9	3	3	3
profit determined according to GAAP	n 16% 33	<input type="text" value="88"/> 42% 88	68 32% 68	23 11% 23	212 100%	2.6	3	3	5
another version of cash surplus (deficit) or profit (loss)? Please specify. NPBIT	n 4	<input type="text" value="9"/>	3	4	20	Not significant number of responses			

20 How important is it, in your view, is it that financial statements confirm the ability of the business to afford the owners' remuneration (salaries, interest on capital, member's salaries etc.)?
(Tick only the applicable box)

	Very important	Important	Less important	Not important	Total
n	115	<input type="text" value="91"/> 91	24	9	239
%	48%	38%	10%	4%	100%

Respondent	
2	No, quite adequate at present
4	Yes
5	Yes
6	No
7	Yes
8	No
9	Absolutely
10	Not really needed, no
11	I do not understand the question
12	Yes
13	N/A
15	No
16	Yes
17	No
18	Maybe
19	It is often not the financial statements that influenced salary
20	Yes
21	Yes
22	No
23	Yes
25	If correctly set out in the notes of the Financial Statement - Present is okay
26	Yes
27	No
29	Yes
30	Yes
32	Yes
33	Nee, die gebruiker moet net vie die info reg interpreteer.
36	Yes
37	Yes

- 38 Nee
- 39 Yes
- 40 Yes
- 42 No
- 43 Members package as a % of total packages
- 45 Yes
- 46 Yes
- 47 No
- 48 No
- 49 No
- 50 Yes
- 51 **Depends on client**
- 52 Yes
- 53 No
- 54 Yes
- 55 Cost of ownership not taken into account
- 57 Yes
- 59 Yes
- 60 May be

- 62 Yes
- 63 Yes
- 65 Yes
- 66 No
- 67 Yes
- 68 Yes
- 72 Yes
- 76 Yes
- 77 No
- 78 Yes
- 79 No
- 81 No
- 86 No
- 91 Yes

- 92 Yes
- 94 **Include fin indicators in AFS**
- 97 No
- 98 Yes
- 105 No, I think if this is a needed a separate confirmation can be given
- 106 Yes
- 107 Yes
- 108 Yes, clients to set up daily on line financial records.
- 109 **Yes, greater clarity is required**
- 112 No
- 113 Yes, members must be shown that capital budgeting is important
- 119 **no**
- 122 **Yes, the real rights and implication of "overdrawing" and the effect on sustainable income is important**
- 123 Yes
- 124 Yes
- 126 Yes
- 127 Yes
- 130 Ja
- 131 **Owners remuneration should be fully set out in a note = tax remuneration - reconciliation done.**
- 132 Yes, very much

- 133 No
- 135 Yes
- 136 Yes, definitely
- 137 No
- 139 Yes
- 140 Sometimes when client discloses all info
- 143 Yes
- 146 Yes
- 147 No
- 148 No
- 149 Yes
- 150 **To me as the accountant - all is clear enough the problem is with my clients, whom doesn't know and understand all of this. all of this.**

- 151 No
- 152 Yes
- 156 No

- 157 Yes
- 159 No
- 160 Yes
- 161 Yes
- 162 Yes
- 166 Yes
- 169 Yes, for future sustainability.
- 172 Yes
- 173 Yes
- 174 Yes
- 175 No, current disclosure is fine.
- 176 Yes
- 178 Yes, cashflow wrote
- 181 No
- 185 Yes
- 192 Fortunately financial statements presentation, changes with the times.
- 193 Yes
- 194 Yes
- 195 Specific additional note with more information on this subject can be inserted.

- 197 No
- 200 No
- 202 Yes, by rearranging the layout of the Income Tax for small owner/managers
- 204 No
- 205 Not exact, figures can be cooked for selfish gain.
- 207 Yes
- 208 Yes
- 209 Not necessarily
- 212 **Management statements better in this regard due to depreciation, provisions, etc.**
- 213 Yes
- 217 Yes

- 218 No
- 219 No
- 226 Yes
- 227 Yes
- 230 Yes
- 231 Yes
- 235 Yes

- 236 Yes
- 239 Yes
- 241 No

22 Which one of the listed three financial values are mostly nurtured by the owner.managers of close corporations in your view?
(Tick only one of the three)

	n	%	Ranking
survival of the corporation	71	28%	3
to support the current lifestyle of the owner(s)	90	36%	1
to grow financially (beyond the needs of the owner(s))	90	36%	1
	<u>251</u>	<u>100%</u>	

23 Which other values (not necessarily financial) values are nurtured by owner-managers of close corporations in your view?

	n	%	Ranking
stability of the corporation	170	72%	1
autonomy of the corporation (independence)	63	27%	2
Other values? Please specify below:	3	1%	
Sustainability	<u>236</u>	<u>100%</u>	
Sustainability and stability.			

24 If you had a free hand to **redesign the financial statements** of close corporations from scratch, to what extent would you **support** the following **suggested changes**:
(Tick the applicable box for each suggestion listed)

The financial statements should:		Fully support	Support	Some support	No support	Total	Mean	Mode	Median	Ranking
		4	3	2	1					
reflect only cash transactions	n	21	41	54	110	226	1.9	1	2	6
	%	9%	18%	24%	49%	100%				
predominantly reflect cash transactions, but also selected accruals (eg. providing for tax payable)	n	57	70	55	37	219	2.7	3	3	4
	%	26%	32%	25%	17%	100%				
reflect tax values as far as possible	n	55	81	54	27	217	2.8	3	3	2
	%	25%	37%	25%	12%	100%				
be in full compliance with GAAP	n	43	64	69	43	219	2.5	2	2	5
	%	20%	29%	32%	20%	100%				
reflect only GAAP, appropriate to the corporation	n	89	75	37	19	220	3.1	4	3	1
	%	40%	34%	17%	9%	100%				
restrict complicated transactions to notes	n	57	86	49	23	215	2.8	3	3	2
	%	27%	40%	23%	11%	100%				
Another suggestion? Please specify below:	n	4	1	4	3	12	Not significant number of responses			

A mixture between GAAP and more practical use.

More detailed Cash flow statement

Relook the wording of the acc. Officers report yo express an opinion on what was done, move to a report that specifically indicates what was done and checked.

Respondent Responses (first mention and cash related bold)

- 2 Detailed notes, but more specific to that of the corporation
- 3 **Simplification/user-friendly** so that owner man can grasp impact of decisions on CC.
- 5 None
- 6 **Reflect the cash transactions**
- 10 SMME business uses reporting fin stats up to threshold
- 11 No charges
- 19 For CC's definitely a shorter balance sheet **without eg cash flow statements**
- 33 **Staat van verandering in aktiviteit is redelik onnodig en nie van veel waarde in die gebruik nie**
- 40 Depreciation and Reserves
- 43 Key performance indicators could be more important. **Results should be presented based on owner needs.**
- 44 Only those appropriate to SME's
- 49 None
- 55 **Limited purpose strictly cater to the users.**
- 58 Notes that are self explanatory should be removed.
- 59 **For micro entities only cash transactions/ For medium entities cash and limited credit transactions/ Big full - GAAP**
- 62 To reflect only GAAP appropriate to the business - Easier understandable, Simpler
- 65 More user friendly to non-financial literate people.
- 66 **Cash flow statement - wording/grouping**
- 70 Eienaars stel belang in
- 71 Restriction of complicated GAAP presentations, rather understandable statements for the normal man in the street.
- 81 Geen
- 88 Inventory valuation and work in progress.
- 90 **Financial Statements must be simple enough for owners to fully understand without explanation from accountants.**
- 94 Financial indicators/ Coming years budgets
- 95 **Cash analysis**
- 96 Include ratios, members report, Cash analysis.
- 97 None
- 102 **Although the owners don't look at the financials they base most of their decisions on the accounting officers opinion. I need to be able to base my opinion on a reliable and exact statement.**

- 106 **More cash related**
- 107 **No cash flow**
- 112 If values of assets/liabilities are shown that is not tax values it normally increases the cost of preparing the financials. Most CC's and small businesses and are not interested in other values as tax values because they only do financials for tax purposes.
- 118 **Comparative figures to cover at least 3 years**
- 122 GAAP reflects some minimum standards - cannot leave interpretations to individual business or accounting persons without GAAP. For CC's the **GAAP practices can be amended to conform with the users abilities to read, analyse and interpret it.**
- 131 The balance sheet should be more detailed for simplicity.
- 135 It **must be interpreted by a professional** to indicate the anticipated future results of the entity.
- 140 Notes, corporate governance
- 146 Mission statement of company
- 147 Owner/managers are mostly interested in the **survival of their entities, so they are mostly interested in cash flows** more than anything, so the other compliance procedures are secondary duties to the entity.
- 150 Clients are only interested in the amount they have to pay to SARS/In person I want rules and regulations to be adhered to, to give structure.
- 153 Indicate tax values
- 156 To comply with all required regulations
- 157 No comment
- 161 **Different values of assets should be elaborated on.**
- 162 Close corporations should accommodate the needs and the levels of the SME.
- 164 Fixed assets to the statement at the **current value**. Book value may differ substantially compared to replacement value.
- 169 Not all GAAP is appropriate to all businesses. None cash transactions affect the future profitability and sustainability of businesses. Tax values of assets are very seldom an accurate reflection of market values.
- 175 No deferred taxation entries, No provisions/write offs (doubtfull debts). Actual Profit/losses incurred in cash.
- 185 Depreciation rates
- 186 Disclosure is important
- 191 **Kontantvloei**, Waardevermindering skedule (kosprys), Opgehoopte waardevermindering, Boekwaarde aankope, verkope, waardevermindering.
- 192 Compliance to **GAAP makes statements, consistent** in certain standards.
- 194 **Easy notes/Cashflow link with bank statement**
- 195 Full compliance to GAAP is not appropriate because the owners/managers often has no interest in the broader details, it also isn't cost effective to spend so much time on the finer details of the format of financials.

- 200 **Refer to 24, I support full disclosure of all aspects risks, provisions and actual transactions. The financials should not**
only provide paperwork for owner / managers but should give a comprehensive reliable picture to all users.
- 201 Notes on sales/turnover in more detail/Notes on extraordinary items (one-off incomes/expenses)/Notes on contingent
incomes/liabilities (not yet recognised on balance sheet)
- 202 Owner/managers normally only look at Income Statement, therefore must simply reflect what has happened during the past full year.
- 205 **Accrual reflect what the totality of close corporation**
- 208 Perhaps add in **some ratios and comparative** recommend ratios for the industry.
- 209 Deferred tax, depreciation and related disclosure.
- 210 **Additional statements** can be added to existing ones.
- 211 **Additional statements depending on type of business/** Adapting certain aspects of the financials to make it more user friendly
and understandable and to the user. To clients its just a piece of paper that they don't always understand yet keep.
- 212 Deferred taxation aspects too complicated for owner managed business.
- 213 AFS should be simple, informative to the user and be relevant to the business
- 217 More user friendly
- 226 **Drop cash flow as it is, GAAP does not always apply**
- 227 Format of disclosure
- 230 Wording to be simplified, Financial Statements to be adjusted to reflect net asset value/ vs Owners/members capital.
- 239 **I don't see the need for cash flows**
- 240 Basis that historical data is represented

26 Do you think it is necessary to simplify financial statements for smaller businesses at all?
Motivate.

Respondent Responses

- 1 **Yes**, most owner-managers do not understand reporting structure and are only interested in whether **they are making money**.
- 2 Yes, small business is really only interested in its return and **bottomline stability**.
- 3 Definitely, most "**complicated reports are superfluous**/clients concerned with how much profit/how much tax/is business growing.
- 4 Yes; income statement, balance sheet and notes supporting the above.
- 5 Yes, they only need what is necessary for them to understand.
- 6 Yes, smaller business only want to know 2 things, the profit and how much tax to be paid. Then a few who will look to balance sheet.

- 7 No
- 8 Yes, for **better understanding by owners**
- 9 Yes, the information must be able to provide more user-friendly **comprehension to clients**
- 10 No, important information might not be elaborated on
- 11 Yes, most SMME business owners, know how to run the business and don't necessarily understand the accounting jargon.
Have we made a profit or not.
- 12 No
- 13 Yes
- 15 No
- 16 Yes
- 17 Yes, make it more user friendly but remember GAAP

- 18 Yes, many owners if not most see financials as an **expense not a tool**
- 20 Yes
- 21 Yes, owners don't understand financial statements, do not always add value
- 22 Yes
- 25 Yes, GAAP is to expensive
- 26 No, it is user friendly
- 27 Yes, would need more space to elaborate
- 29 Yes, what does the user require
- 31 No
- 32 Yes
- 33 nee
- 35 Yes, the owners do not understand accounting terms and **will appreciate laymans terms**

- 38 Nee
- 39 No
- 40 No
- 41 Yes, make them more user-friendly
- 42 Yes, include **more visual aids graphs etc.**
- 44 Yes, they don't understand GAAP
- 45 Yes, more understandable and practical.
- 48 Ja
- 49 No

52 No, whether you have a small business or a large one, you need as **much financial info as possible in order to make the correct decisions.**

53 Not in case of my particular CC's.

54 Yes, it should empower owner to make **decisions that will enhance** overall operational efficiency, in measures that are easily understood by him/her.

55 A good balance depending on the users

56 Yes

57 Yes, enhance the usefulness for debts

58 Yes, sometimes AFS are only analysed for tax purposes.

59 Yes, too costly, members are totally accounting illiterate, very expensive yet useless Acc Off report.

62 Yes, SME owners don't care about all the GAAP specifications.

63 No

65 Yes, see above

66 No, rather explain/educate what the purpose is of Financial Statements and how they were compiled.

67 Yes, easier to understand

68 Yes, make the financial statement more user friendly and understandable for the business.

69 Yes, to costly to do a full statement on small accounts

71 Yes, many CC members know business, and not much about accountancy.

72 Enkel gebruikers het nie waarde in FJS nie. Hulle wil net weet was die wins/vals en belasting.

75 No

76 Yes, in order for the unsophisticated person to understand.

79 Nee

81 Nee

CF 84 Small business - ignore cashflow

CF 85 **Could exclude the cash flow statement and MNI statement.**

86 Not if it prevents/restricts disclosure of the economic reliability eg Deferred tax

88 Yes, less burden on cash flow

90 Yes, as the accounting fees for small businesses are relatively small, the practitioner should be allowed to simplify the AFS to reduce his costs and labour. This is only one of many reasons. Another is explained in no 25 above.

92 Yes it is very expensive and **onerous to prepare GAAP compliant AFS** for small businesses.

93 **Yes as 95% of (SME) business owners are more concerned with survival of the business.**

94 Yes, it is only history for small business.

- 95 Yes as those business do not have accounting knowledge as well as GAAP.
- 96 **Yes, provide better understanding to the owner and include useful information. Move away from "financials are only for banks and SARS" Start showing value to owners as well.**
- 97 No
- 98 Yes, to facilitate understanding by owner/members who may have no accounting background.
- 99 **Yes, do away with members statement of interest, cash flow statement.**
- 100 No
- 102 **No, I think the financial statements that we prepare at the moment are as simple as it should get. Anything less might compromise the reliability.**
- 103 Yes
- CF 106 **Much is unnecessary ie Cash Flow Statement**
- 107 No
- 108 Many owners do not care about all papers that is irrelevant
- 109 Yes, so that more time is spent on being less of an historian and more of a current situation advisor.
- 112 not interest them.
- Yes, very small businesses only do financials for SARS. Therefore cash flow statements balance sheets and notes do not interest them. Members net investment statements also do not interest them.
- 113 **Yes, members must make more use of financial statements, other than for tax purposes only. By simplifying they might do just that.**
- 114 Yes, most members of these businesses don't understand financial statements.
- 116 Yes, see number 12
- 117 **Financial statements are primarily designed for corporates - SME sector businesses need more management information than "once a year historic reporting.**
- 118 No - Educate the users on how to use this information better in 8.
- 119 No - clear enough
- 120 **No, to simplify statements to much would defeat the purpose of drafting financial statements. Would make more work for the accountant/auditor (unnecessary) to supply in the needs of every user of the financial statements.**
- 121 Yes, the owner needs to understand the financial statements, without having to become a bookkeeper or an accountant
- 122 Yes, some of the notes regarding disclosure of certain information very elaborate and unnecessary example: "Income/Turnover recognition".
- 125 Yes
- 126 Yes
- 128 Yes, small business does not have need for info as required by law. Most users interested in profit/tax of company.

- 129 Income statement, Balance Sheet and notes sufficient.
- 130 Ja, kliente nie rekeningskundig oorle nie
- 131 Yes, detailed balance sheet of all items currently grouped under sub headings like = short term financing - detail what they are - motor vehicle short term time etc.
- 132 Yes, for more understanding
- 133 Some client said the only reason we have a job is because of SARS
- 135 No it is too simple as it is to be usefull.
- 136 The AFS should be prepared as a tool which even management can use in making future predictions and decisions.
- 137 **No, just educate the members/management accordingly.**
- 139 Yes, more clearer for owner, simpler
- 140 Yes, limited GAAP especially compliance, Regulation and compliance standards.
- 141 Limited disclosure financial statements are imperative for the survival of the small business entities.
- 142 Yes, because most owners/members do not understand GAAP and only want to know how much tax they have to pay.
- 143 **Yes, because SME's are normally tradesmen/professionals in their field and not financial studies. They must understand these statements.**
- 144 Yes, for the owners to understand it more easy.
- 146 **Yes, elimination of cash flow statement**
- 147 Yes. So that they can be more useful to them.
- 148 No
- 149 Yes, for better understanding
- 150 No, I think our **clients need education.**
- 151 Yes (owner/manager)
- 152 Yes
- 153 Yes, in that cash values are indicated and taxes.
- 154 Yes, most small businessse owners cannot read or interpret financials as a result simple financials will be of value to them.
- 156 Yes, to keep it as simple as possible.
- 157 No, they are **simple enough as they only need presentation.**
- 158 My clients use their monthly management accounts which are suited to them and the info they require. A full set of financial statements are prepared annually and are basically for SARS and the Bank! I would be interested to know what they think.
- 160 No
- 161 **Yes**, so that we can perform SME need and one owners interest, but still compliance or **not conflicting with the GAAP.**

- 164 No
- 165 **Yes, it would enable the owners to actually use them.**
- 168 Yes, management tool
- 169 **Yes, but not to the extent that they will be meaningless to other users. Eg. Banks**
- 170 Yes, it must be set out as simple as possible, because they don't have financial managers and normally limited financial skills themselves.
- 173 Yes, cost us benefit basis.
- 174 Yes
- 175 Yes, businessmen are presented with info not understood or historically irrelevant.
- 176 Yes, more user friendly
- 177 Yes
- 178 Statement - Movement, equity
- 179 Yes
- 183 Yes, in order to make it easier for clients to make financial decisions without really being a fundi in interpretation of financial statements.
- 185 Yes
- CF 186 The most common question asked: "what does my business owe me? The old fashioned cash flow statement was much more informative.
- 190 Yes, it will be used more by owners as a tool.
- 191 Ja, finansiele inligting moet vergelykbaar wees.
- 192 **Yes, however the accountants work still plays an important role to interpret them, even if they are simple.**
- 194 Yes, easy to read and understand by owner.
- 195 Yes, see above
- 196 Yes, it can help to report to owner-managers.
- 197 No
- 200 No, but not full GAAP, which is extensive and non specific.
- 201 Yes, according to financial intelligence of prospective users.
- 202 Yes, time factor in preparing AFS makes it expensive for owner/managers.
- 203 Yes
- 205 No
- 206 No
- 207 Yes
- 208 No
- 209 No, they are fairly simple, perhaps it is the disclosure requirements that may be simplified.

- 210 We need certain standard financial statements.
- 211 Yes, have a guide with standards applicable to the various - compulsory, with additional standards, that are optional so standards can be individualised.
- 212 See 25 Accountants should however educate their clients too.
- 213 Yes, many small businesses do not even know how to read the financial statement. You have to explain to them everything written.
- 214 Most of our clients do not understand a cash flow statement.
- 218 No
- 220 Yes
- 221 No
- 222 Yes, GAAP to complicated for small businesses.
- 223 Yes
- 226 Must be supplied as members do not understand. Because they are not user friendly, clients are embarrassed to ask questions.
- 227 Yes, most owners have a limited knowledge of financial analysis. They know how to make money not manage it.
- 230 Yes, many persons involved in SMME's do not have an extensive education and we do not understand. The bottom line type of question is "How much tax and I paying"?
- 231 Yes, more and more are entering into business and as a result need Financial statements. They have no prior knowledge of reading or interpreting financial statements.
- 236 No
- 238 No
- 239 It is simple enough
- 240 Yes, smaller, easier are better as they will add value and thus are not only done for tax purposes.
- 241 No

27 Are the financial statements of your close corporation clients audited?
(Tick only the applicable box)

	Annually	Some- times	Never	Total
n	16	69	149	234
%	7%	29%	64%	100%

As expected, the vast majority of CCs' would not be audited; the correlation between respondents stating that ccs' are audited and reported size of ownership, once again would be interesting.

28 To what extent, in your view, would the following possible benefits of an annual audit apply to this corporation ?

(Tick the applicable box for each listed possible benefit)

	Very applicable 4	Applicable 3	Less applicable 2	Not applicable 1	Total	Mean	Mode	Median	Ranking
Fraud detection	n 31 % 14%	66 30%	59 27%	66 30%	222 100%	2.3	3;1	2	2
to make financial statements more credible for outsiders	n 53 % 23%	87 38%	43 19%	44 19%	227 100%	2.7	3	3	1

29 How important, in your view, is an unqualified audit report?

	Very important 4	Important 3	Less important 2	Not important 1	Total	Mean	Mode	Median
	n 84 % 37%	85 37%	39 17%	21 9%	229 100%	3.0	3	3

Respondent Responses

10 An unqualified audit report, makes no sense to word Audit (principal of an audit)??

19 For a CC that's owner managed the audit report is immaterial

22 For future investors to be notified

27 Credible to third parties

38 Prof standaard is hoogenoeg as CPA lid

41 It shows we've done all possible to ensure fair representation.

44 For external users

- 45 Good governance and for **public satisfaction** on clients dealing with company
- 46 Only confirm something is wrong
- 47 Indien van toepassing
- 48 CC Nee
- 50 Dit gee versekering vir die gebruiker van die inligting woen in ??
- 52 The reason for the unqualified report must be stated in the accounting officers report.
- 53 Integrity/credibility
- 55 Show true reflection of results
- 57 Ownership is restricted to one person
- 58 When understanding the audit report, one can establish approx what reliability can be placed on AFS.
- 59 It gives credibility to the AFS.
- 60 For 3 parties to know what really happened.
- 63 n Ongekwalifiseerde oudit verslag se niks, daar ken net aanvaar word als is in orde.
- 65 Audits are based on selections and therefore would not detect all fraud or incorrect fin. Info.
- 66 Depends on what is qualified.
- 68 Work with information from the client
- 70 Die bepaal die slalus van die verslag
- 72 Indien dit nodig is om te kwalifiseer moet dit gedoen wado erlike optrede.
- 90 In a CC irrelevant, but in a company, it reflects whether the company is being properly Managed
- 91 But it must be truly unqualified.
- 92 For banks, creditors, new investors
- 97 It gives assurance that the business is free of maternal mistatements.
- 102 Except for books nobody looks at a small business financial statement
- 105 It shows there could be risk involved
- 106 Not always relevant to current trading
- 112 Audits supposed to give a greater amount of surety. If the report is qualified there is no surety.
- 113 An unqualified audit report shows that reasonable care has been taken that the Financial Statements are correct.
- 115 iro SARS and banks
- 120 Relates to the credibility (reliability on) of the financial figures of the entity.
- 121 A qualification report could indicate or trigger many question or acceptance of the financial statement.
- 123 End user would be alerted to misconduct in the company in the event of a qualified report.
- 124 Places reliance on the financials
- 125 Allow owner some responsibility for corporate governance
- 127 Clients are not interested, only in tax and bank needs.

- 128 Reason for qualifying report not always clear, what 's wrong in business?
- 129 Qualifications make financial statements less reliable.
- 131 A qualification might be merely due to non compliance with GAAP and not critical to the AFS.
- 135 Nobody reads it in any case
- 136 Depending on the nature of the qualification only.
- 137 To motivate that everything is in order.
- 140 Depends on integrity or auditors/personal relations with client/vested interests.
- 141 The qualified report shows that there is a risk that auditor was not prepared to ignored, but probably could not quantify.
- 147 It gives credibility on the financial statements.
- 149 Less financial problems
- 150 In small businesses, no one ever looks or worries about the qualification.
- 151 Most of owner/managers don't understand a audit report.
- 152 Means nothing to owner
- 153 It indicates in most cases the inefficient or inadequacy of the cashflow.
- 156 Would show some kind of disclosed item.
- 157 Because you cannot audit and never have a qualified report.
- 160 Important for certain users of AFS, Banks, Creditors
- 161 Auditor is only expressing an opinion. Everyone is entitled to an opinion but...
- 162 To know the risk of the company.
- 164 An unqualified report would indicate to the user thereof not to place 100% reliance on the financial statements.
- 165 It gives comfort to SARS and Banks.
- 169 Because of the assurances one can place on the AFS, although I have heard of inconsistencies amongst auditors.
- 170 At least you know the work is done right or at least right.
- 173 Obtain contracts
- 178 Professional Integrity/Knowledge/Insurance
- 179 Reassurance to 3rd parties all is well.
- 181 Figures can be relied on to a greater extent. Depending on the extent of the audit. Likelihood of fraud overstating sales etc. is limited.
- 185 Irrelevant
- 188 Never received a comment of any kind on a qualified report.
- 189 Above board, Integrity
- 191 Die finansiële state moet ooreenstem met finansiële inligting.
- 194 Have no credibility
- 195 For reliance on figures by outsiders.
- 197 As important as a qualified audit report is, it should be based on actual performances.

- 200 It is important only if seen in context that it is not a "default" but a true decision. I would rather qualify for a specific reason and have confidence that the work was performed properly.
- 201 An unqualified audit report is currently the highest level of assurance to users of the financial statements.
- 202 An AFS used by bank and tax authority they need to be sure figures are a true reflection of results.
- 205 Credibility to CC for users
- 206 Would affect the decision of banks to finance the business.
- 209 To ascertain the element and extent of risk, non compliance and level of adherence to corporate governance.
- 211 Highlights possible problems, in light of the situation! Integrity of the individual at stake: Very Important
- 212 A qualified report alerts a user.
- 213 All information on the AFS should be as far as possible
- 218 Only really "major issues" lead to qualified reports - most audit reports are not qualified.
- 222 Gives credibility to FS
- 226 1 out of 1000 reports are qualified and I do not believe that the 9999 are squeaky clean. My accounting officers report is good good enough. If I do not disclose irregularities, I must be held accountable.
- 227 Qualifications would highlight pertinent and serious problems in an organisation.
- 231 This would enable financial distributions to continue granting credit.
- 233 Serves as an indicator if complete reliance can be placed on AFS.
- 235 Because financial institution rely on it for financing purposes
- 238 Hoeveel mense kyk werklik na n verslag. Nie eers die banke nie.
- 239 If not unqualified - it raises an immediate flag.
- 240 Any qualification has result to make AFS unnecessary, Third parties become uninterested.
- 241 No value (integrity)

Annexure 3
Questionnaire to be used in a semi-structured interview with owner-managers

Position of member / owner interviewed

- 1 How many members / owners does the corporation / concern have?
(Tick only the applicable box)

1	2	3	4	5	More than 5
---	---	---	---	---	-------------

If your answer to question 1 was "more than 5", please specify the applicable number.

- 2 How many employees does the corporation / concern have?
(Tick only the applicable box)

1	2	3	4	5	More than 5
---	---	---	---	---	-------------

If your answer to question 1 was "more than 5", please specify the applicable number.

- 3 How many of the members are active in the management of the corporation?
(Tick only the applicable box)

1	2	3	4	5	More than 5
---	---	---	---	---	-------------

If your answer to question 2 was "more than 5", please specify the applicable number.

4 In which (broad) sector does the corporation operate?
(Tick only the applicable box)

- Manufacturing
- Trading
- Services
- Other (Please specify below)

5 Briefly explain the main operations of the corporation

6 How long has the corporation been in operation?
(Tick only the applicable box)

- less than one year
- one to five years
- more than five years (please specify)

7 Does a member / owner or employee perform all or part of the bookkeeping?
(Tick only the applicable box)

 Yes No

8 If your answer is yes, specify the kind of bookkeeping tasks performed by the "inside bookkeeper":

9 Does the business also have an "outside accountant"? If yes, which tasks are performed by the accountant?

10 To what extent do the owners of the business depend on the accountant for advice in financial decisionmaking?

11 Does the business **buy** on **credit**:
(Tick only the applicable box)

Always	Often	Seldom	Never
--------	-------	--------	-------

12 Does the business **sell** on **credit**?
(Tick only the applicable box)

Always	Often	Seldom	Never
--------	-------	--------	-------

13 Which **journals** of first entry are being used to record the transactions of your business?
(Tick yes or no)

Only cash journals/ cash book	Yes	No
cash journals and general journal		
a comprehensive set of journals		

14 Which of the following (more advanced) transactions, do your corporation engage in? (Please tick yes or no)

	Yes	No
foreign exchange	<input type="checkbox"/>	<input type="checkbox"/>
leases/ hire purchase	<input type="checkbox"/>	<input type="checkbox"/>
revaluation of assets	<input type="checkbox"/>	<input type="checkbox"/>
depreciating assets	<input type="checkbox"/>	<input type="checkbox"/>
other? (please specify)	<input type="checkbox"/>	<input type="checkbox"/>

15 Which accounting practices do you regard as important to maintain financial discipline in your business? (eg. VAT records; other accounting records etc.)

16 How often are the following financial decisions being taken / financial activities being performed, in your business?
(Tick the applicable box for each decision / activity listed)

	Daily	Monthly	Seldom	Never
the timing of settling debts to suppliers	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
the timing and amounts members remuneration (salaries, interest on capital, bonuses and other distributions)	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
to purchase inventory	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
the choice for capital assets eg. Vehicles and equipment	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
how to finance capital assets	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
budget preparation or maintenance	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
members' loan maintenance	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
employee salary or bonus decisions	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
to request (or secure) an increased credit facility (including a bank overdraft)	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
financial comparisons amongst years	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
price increases for products or services	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
cash flow projections	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
expansion of business	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
Calculation of income tax due	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>

(including a bank overdraft)
17 (continued)

financial comparisons amongst years					
price increases for products or services					
cash flow projections					
expansion of business					
Calculation of income tax due (and tax planning in general)					
Valuation of business					
Recruiting staff					
Marketing					
Debt collection					

18 Do you reflect on a annual basis (or more regularly) on the financial position and performance of your business? If yes, elaborate on how you do it.

19 Can you distinguish an income statement, balance sheet, cash flow statement, statement of receipts and payments (i.e. components of AFS). Do you use it at all?

20 Do you regard the financial statements of the corporation in their **current format** as:
simple and user friendly enough?

21 Are there certain obvious aspects of financial statements which, in your view, do not consider the specific needs of smaller businesses (eg terminology used etc.)?

22 The term "turnover" or "sales", has most value to you if it includes:
(Tick only one of the three alternatives)

- all work invoiced during the year
- cash received from customers during the year
- something else (please specify)

23 The term "purchases", has the most value to you if it includes:
(Tick only one of the three alternatives)

- all work invoiced during the year
- cash paid to suppliers during the year
- something else (please specify)

24 How often do you use each of the following indicators of financial performance for your business?

(Tick only the applicable box in respect of each listed indicator)

Daily Monthly Annually Never
(or more)

turnover/ sales

the bank balance

profit (or loss) per income statement

a cash surplus (or deficit)

another financial performance indicator? Please specify below:

25 Any other comments on indicators of financial performance?

26 Is it clear to you which amounts (in the form of salary, interest on capital etc.) you can use for personal use without jeopardising the smooth operating of the business?

27 Which one of the listed three financial values are best nurtured by you and the other owners of the corporation?
(Tick only one of the three)

- survival of the corporation
- to support the current lifestyle of the owner(s)
- to grow financially (beyond the needs of the owner(s))

28 Which other values (not necessarily financial) values are nurtured by you and the owners of the corporation?

- stability of the corporation
 - autonomy of the corporation (independence)
 - Other values? Please specify below:
-
-

29 Do you think it is necessary to simplify financial statements for smaller businesses at all?
Motivate.

30 Are the financial statements of this corporation audited sometimes?

(Tick only the applicable box)

Annually Some-
times Never

<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
--------------------------	--------------------------	--------------------------

31 Which benefits, in your view, of an audit would the benefit your entity (e.g. Fraud detection, credibility enhancement etc.)?

32 Do you think accountants (not registered as chartered accountants and auditors) can offer an adequate service to make financial statements credible for outsiders?

33 Would you like feedback on the analysis of this questionnaire?
(Tick only the applicable box)

Yes

No

If yes, please supply some or all of the following information:

Name _____

e-Mail address _____

Telephone _____

Annexure 4

Questionnaire summary: semi-structured interview with owner-managers

<u>Res,</u>	<u>Position of person interviewed</u>	<u>Firm</u>
1	Main member	911 Workshop
2	Main member	The Futute Home Corporation CC
3	Main member	Leewfontein (boerdery)
4	Managing director	Gripper and Co (Pty) Ltd
5	Operation s manager	Hetzner (Pty) Ltd
6	Sole Member	CIM Systems CC
7	Main member	Cape Atlantic Projects CC
8	Only member	G+A Promotions CC
9	Financial manager	Action Ize CC
10	Only member	Cape Town Sewing Centre CC
11	Admin/HR/Fin manager	Ant Agencies CC
12	Admin member	Soundworks CC
13	Sole Member	Eminent solutions CC
14	Sole Member	Zanco Engineering CC
15	Sole member	Rosenpark Motors CC
16	Sole member	Golden Spur Newlands CC
17	Sole member	FG Motors CC
18	Financial member	Antoinette Eiendomme CC
19	Sole owner	Shalom Enterprises
20	Sales and marketing manager	Eoroafrican Industrial Agencies (Pty) Ltd)

How many members / owners does the corporation / concern have?
 (Tick only the applicable box)

Res,	1	2	3	4	5	5+	Details
1		1					Husband and wife
2			1				Husband, wife and daughter
3		1					Husband and wife
4					1		Managing director
5	1						Managing director
6	1						Owner-manager
7		1					Two members / Main member has other income as well
8	1						Member solely reliant on this business
9		1					Two members
10	1						Owner-manager
11		1					Husband and wife
12		1					Husband and wife
13	1						Sole member
14	1						Sole member
15	1						Sole member
16	1						Sole member
17	1						Sole member
18		1					Husband and wife
19		1					Husband and wife
20	9	8	1	1	1	0	Family business

2. How many employees does the corporation / concern have?
 (Tick only the applicable box)

Res,	1	2	3	4	5	5+	Details
1	1						Mechanic
2						1	Three sub contractors
3			1				Farm workers
4						1	10 Admin and technical staff
5						1	35
6						1	7
7						1	Nine + subcontractors
8						1	Fifteen
9						1	Six
10						1	Six
11	1						
12					1		
13	1						
14						1	Fourty three
15						1	Nine
16						1	Eight
17			1				
18		1					
19							None
20	3	1	2	0	1	12	Eleven

3 How many of the members are active in the management of the corporation:
 (Tick only the applicable box)

Res.	1	2	3	4	5	5+	Details
1		1					Both
2		1					Both
3		1					Two of three
4					1		Three management / two employees
5	1						The only one
6	1						The only one
7		1					Both
8	1						The only one
9		1					Both
10	1						The only one
11		1					Both
12		1					Both
13	1						The only one
14	1						The only one
15	1						The only one
16	1						The only one
17	1						The only one
18		1					Both
19		1					Both
20	9	9	0	1	1	0	All four

4 - 5 In which (broad) sector does the corporation operate?
Briefly describe the main operations of the business

Res,	Man	Tra	Ser	Oth	The main operations
1			1		Second hand car repairs
2				1	Restoration and building in Northern suburbs Cape Town
3				1	Mixed farming; North Eastern Cape, stock and cultivation
4	1				Industrial automation
5			1		Web hosting
6			1		Buy and sell electronic parts/ some development work
7	1				Building residential houses
8	1				Manufacturing of clothing for racing drivers
9	1				Manufacturing of swimwear
10		1			Haberdashery and fashion trim saLES
11				1	Import and supply leathers (hydes) to manufacturers
12		1			Selling and installation of sound equipment
13			1		IT sales and support
14	1				Manufacturing and construction of steel structures
15			1		Workshop specialising in fuel injection, electric ignition etc.G312
16			1		Steak Ranch
17		1			Second hand car sales
18		1			Property marketing and sales and rental of property
19		1			Selling health and cleaning products
20		1			Import and sell gas and electric appliances and hearing equipment
	5	6	6	3	

6 How long have the corporation been in operation:
 (Tick only the applicable box)

Res,	1	1- 5	5+	Details
1			1	Twenty two years
2			1	Twenty years
3			1	Twelve years
4			1	Thirty years
5			1	Six years
6			1	Fifteen years
7			1	Five years
8			1	Thirteen years
9			1	Thirteen years
10			1	Seven years
11		1		Five years
12			1	Fifteen years
13			1	Six years
14			1	Eleven years
15			1	Eleven years
16			1	Six years
17			1	Twelve years
18			1	Fifteen years
19			1	Eighteen years
20	0	1	19	Fourty three years

7+8 Does a member / owner or employee perform all or part of the bookkeeping?
(Tick only the applicable box)

Res,	Yes	No	Tasks performed
1	1		Member compile only cash records and fill out VAT returns
2	1		Member compile cash journals on Pastel, reconcile +VAT returns
3	1		Member compile cash journals on Pastel, reconcile +VAT returns
4	1		Employee captures transactions on PASTEL / MD interprets reports himself
5	1		Pastel dumped into excell
6	1		Pastel dumped into excell
7	1		Income detail and payroll on excell; rest on PASTEL
8	1		Manual VAT records (which he uses as management accounts)
9	1		PASTEL including reports/ Cash flow etc Excell
10	1		PASTEL up to trial balance
11	1		PASTEL; including reports; B/S, I/S +cash movement statement (do VAT also)
12	1		Twelve column cash book and VAT
13	1		Member does quick books; capturing+basic reports+ VAT
14	1		Three people including the owners wife; PASTEL, verify bookkeeping+E368 work, do trial balance
15	1		Wife plus two others; PASTEL +monthly man. Accounts +VAT
16	1		Employee does customised system up to income statement
17	1		Owner does customised system for VAT and AFS
18	1		Only for rentals
19		1	All source documents directly to accountant
20	1		PASTEL and VAT
	19	1	

9 Does the business also have an "outside accountant"? If yes, which tasks are performed by the accountant?

Res,	Yes	No	Tasks performed
1	1		General journal, AFS, income tax returns
2	1		General journal, AFS, income tax returns
3	1		General journal, AFS, income tax returns, analysis of AFS and periodic advise
4	1		An auditor
5	1		An auditor
6	1		Accounting officer
7	1		Accounting officer; income tax and periodic advise which is appreciated much
8	1		Accounting officer; income tax and VAT returns using VAT records as source.
9	1		Accounting officer AFS once a year; member regard as management statements
10	1		Accounting officer AFS once a year; only statutory function
11	1		Accounting officer AFS once a year; only statutory function
12	1		Accounting officer AFS once a year; only statutory function
13	1		Accounting officer AFS once a year; only statutory function
14	1		Monthly manufacturing accounts; VAT; AFS
15	1		Accounting officer AFS once a year; only statutory function
16	1		Accounting officer AFS + soundboarding
17	1		Accounting officer AFS with annual review
18	1		Accounting officer AFS plus VAT
19	1		Does journals, VAT and AFS
20	1		Audit AFS ; need is forming for monthly management account routine
	20	0	

10 To what extent does the owners of the business depend on the (outside) accountant for advice in financial decisionmaking?

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Res, Details	Large	Small	Stat/technical
1 Only for technical advice on bookkeeping procedures.			1
2 Seldomly; only to support supporting documentation for bank.			1
3 For all big decisions	1		
4 MD interprets financial reports himself			1
5 Ops. Manager give all advice from excell reports			1
6 Only tax related - owner manager compile own (excell) reports			1
7 Income tax; loan accounts and periodic advise which is appreciated much by main member		1	
8 Do not depend on outside accountant; sees outside accountant as serving just a statutory function			1
9 Accounting officer; Minor role in decisionmaking		1	
10 Not at all			1
11 Leads annual reflection; advises specifically on members remuneration	1		
12 Leads annual reflection; advises specifically on cost control and operational improvements	1		
13 Quite; especially strategic talks	1		
14 Strongly on a weekly basis	1		
15 Mainly tax related			1
16 Accounting officer is a soundboarding function (member very knowledgeable)		1	
17 Not at all			1
18 Not at all			1
19 Tax related emphasis. Annual reflection also emphasises budgeting exercise	1		
20 Tax related emphasis.			1
	6	3	11

11 Does the business buy on credit:
(Tick only the applicable box)

Res,	A	O	S	N	Details
1			1		
2		1			Always 30 days settlement if possible.
3		1			
4	1				
5		1			
6		1			
7		1			
8			1		
9	1				
10		1			
11		1			
12		1			
13			1		
14	1				
15	1				
16			1		Two week terms
17				1	
18			1		
19				1	
20	1				
	5	8	5	2	

12 Does the business sell on credit:
(Tick only the applicable box)

Res,	A	O	S	N	Details
1			1		
2				1	
3				1	
4		1			
5	1				
6		1			
7		1			
8			1		Two big customers and some small ones
9	1				
10				1	
11		1			
12				1	
13				1	
14	1				
15				1	
16				1	
17				1	
18				1	
19				1	
20	1				
	4	4	2	10	

13 Which journals of first entry are being used to record the transactions of your business:

Res,	Cash	Ca+G	Com	Details
1	1			General journal only by external accountant
2	1			General journal only by external accountant
3	1			General journal only by external accountant
4			1	
5			1	
6			1	
7			1	
8				Non; bank statements and VAT records only source
9			1	
10			1	
11			1	
12	1			Plus excell purchases, sales and stock records/invoices in pending file
13	1			Cash+ creditors journal
14			1	
15			1	
16			1	Customised system
17	1			
18	1			
19	1			
20	8	0	11	

14 Which of the following (more advanced) transactions, do your corporation engage in: (Please tick yes or no)

Res,	For	Leas	Rev	Dep	Details
1	1	1		1	Once off parts imported
2		1		1	
3		1	1	1	Biological assets and property at fair value, integral part of performance measurement.
4	1	1		1	
5	1	1		1	
6		1		1	
7		1		1	Depreciation by accounting officer
8	1	1		1	Depreciation by accounting officer
9	1	1		1	Royalties for licencees tricky
10	1			1	
11	1		1		Freight duties complicated
12	1	1		1	HP very rarely
13		1		1	
14	1	1	1	1	
15		1		1	
16		1		1	
17				1	
18				1	
19				1	
20	1		1	1	
	10	14	4	19	

15 Which accounting practises do you regard as important to maintain financial discipline in your business (eg. VAT records, other accounting records, accountants involvement).

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		Full sys	Other	Details
1	VAT and other records good; accountants involvement also good	1		
2	Quotes for individual contracts regarded the life blood of the business.		1	Quotes
3	VAT and other records good; accountants involvement also good	1		
4	Believes in nothing less than a full accounting system	1		
5	Believes in nothing less than a full accounting system	1		
6	Purchase, sales and expense records adequate		1	Purchase, sales and expense records
7	Records needed to calculate profitability of each contract		1	Profit per contract
8	Regular scrutiny of bank statements and only spend available cash.		1	Bank statements
9	Believes in nothing less than a full accounting system	1		
10	Believes in nothing less than a full accounting system	1		
11	Believes in nothing less than a full accounting system	1		
12	Believes in nothing less than what they do at present	1		
13	Believes in nothing less than what they do at present	1		
14	Believes in nothing less than what they do at present; but would prefer manual system	1		
15	Believes in nothing less than what they do at present	1		
16	Believes in nothing less than what they do at present	1		
17	Believes in nothing less than what they do at present	1		
18	Still AFS	1		
19	The whole system	1		
20	A proper system	1		
		16	4	

the timing of settling debts to suppliers

Res,	Daily	Monthly	Seldom	Never	BS	AFS	BUD	Man acc	Acc adv	Comments	Terms	Cash	N/A
1		1			1					Try to stick to 30 days	1		
2		1			1					Try to stick to 30 days	1		
3		1			1					Cash flow determined		1	
4		1						1		Also informed by discounts		1	
5		1								Policy driven	1		
6		1								Policy driven	1		
7	1				1					Cash flow determined		1	
8	1				1					Cash flow determined		1	
9		1								Agreement	1		
10		1			1					Policy driven	1		
11		1			1					After creditor recon		1	
12	1	Ongoing			1					Agreement + discounts drive	1		
13		1								Agreed terms	1		
14		1								Thirty days	1		
15		1			1					Thirty days	1		
16			1							Terms	1		
17				1						N/A			1
18			1							Terms	1		
19				1						N/A			1
20		1			1					Terms	1		
	3	13	2	2	10	0	0				13	5	2

the timing and amounts members remuneration (salaries, interest on capital, bonuses and other distributions)

Res	Cash										Needs/			
	Daily	Monthly	Seidom	Never	Base	BS	AFS	BUD	Man acc	Acc adv	Comments	Res	Cash	AFS/Man
1	1				1						Needs driven	1	1	
2	1				1	1					Needs driven	2	1	
3	1				1	1	1				Routine B/S ; Non routine budge	3	1	
4		1	1	Annually			1	1			Availability of cash	4		1
5		1	1	Annually			1					5		1
6	1			Ongoing							Simply take extra cash	6	1	
7		1									Fixed salaries based on survival	7	1	
8		1									Fixed salaries based on survival	8	1	
9	1						1				Reported rem. only tax trick	9		1
10			1	Annually			1	1			Salary + annual distribution	10		1
11			1	Annually			1					11		1
12		1			1	1					Salary based on need	12	1	
13	1	Ongoing			1	1	1				AFS check to confirm	13		1
14		1					1	1				14		1
15		1					1		1		Not a topup	15		1
16		1						1				16		1
17			1	Once a	1		1	1			Salary det. from stand.of living	17		1
18		1			1	1					Needs driven salary	18	1	
19	1	Weekly			1	1			1			19		1
20		1									Fixed salary +comm on sales	20	1	
6	9	5	0	8	6	8	3	5	2				9	11

Res	Daily	Monthly	Seldom	Never
1	1			
2	1			
3		1		
4	1			
5	1			
6	1			
7	1			
8	1			
9	1			
10	1			
11		1	Bi monthly	
12	1	Ongoing		
13	1	Ongoing		
14	1			
15	1			
16	1			
17	1			
18				
19	1	Weekly		
20	1			
	17	1	1	0

BS	AFS	BUD	Man acc	Acc adv	Comments	Need
					Driven by specific job	1
					Driven by contracts; quotes	1
1		1			Need and ability	1
					Inv control / needs driven	1
					Needs driven	1
					Inv control / needs driven	1
					Needs driven	1
					Needs driven+provision for inventory	1
					Needs driven+provision for inventory	1
					Needs driven+provision for inventory	1
					Needs driven+provision for inventory	1
					Stock level driven+demand	1
					Minimum stock level driven+demand	1
					Job driven	1
					Small stock; mainly job driven	1
					Needs driven	1
1					Needs driven	1
					N/A	
1					Needs driven	1
					Sales records/ provide for lead time	1
3	0	1	0	0		19

the choice for capital assets eg. Vehicles and equipment
and how to finance it

Res	Daily	Monthly	Seldom	Never	BS	AFS	BUD	Man acc	Acc adv	Comments	Needs	Cash	Policy	Acc ad
1			1							Lease or HP in principle			1	
2			1							Own judgement	1			
3			1		1	1			1	Well planned				1
4			1							Needs driven	1			
5		1								Needs driven	1			
6			1							Needs driven	1			
7			1							Needs driven	1			
8			1							Very rarely; only need drives	1			
9			1							Very rarely; only need drives	1			
10			1		1					Replacement computers etc.	1			
11			N/A							N/A				
12			1		1					Cash where possible		1		
13		1								Demand / cash		1		
14										Replacement driven	1			
15	As needed		1		1					Mainly cash		1		
16			1							Needs driven	1			
17			N/A							N/A				
18			1		1					Cash where possible		1		
19			1							Needs driven / max debt			1	
20			1							Needs driven / HP	1		1	
	0	2	16	0	4	1	1	0	1		11	4	3	1

how to finance capital assets

(See previous section as well)

Res	Daily	Monthly	Seldom	Never
1			1	
2			1	
3			1	
4			1	
5		1		
6			1	
7			1	
8				
9				
10				1
11				1
12				
13				
14				
15				
16				
17				
18				
19			1	
20			1	
	0	1	8	2

BS	AFS	BUD	Man acc	Acc adv	Comments
					Integrated with investment decision
					Integrated with investment decision
	1	1		1	Integrated with investment decision
					Needs driven
					Needs driven
					Needs driven
					Needs driven
					Cash if possible
					Policy; lease or cash
					N/A
					N/A
					N/A
					Cash if possible
					HP or cash
					N/A
					N/A
					N/A
					N/A
					Maximum debt
					HP
0	1	1	0	1	

budget preparation or maintenance

1-4

Res	Daily	Monthly	times	Never
1				1
2				1
3		1		
4		1	Quaterly	
5				1
6			1	
7				1
8		1	Annually	
9		1	Quaterly	
10				1
11				1
12				1
13				1
14		1	Quaterly	
15		1		
16		1		
17			1	Annually
18				1
19			1	Annually
20	0	3	7	10

Cash

BS	AFS	BUD	Base	Man acc	Acc adv	Comments
			1			N/A
			1			N/A
	1	1				ABSA format; monthly monitored
	1			1		N/A
				1		N/A
				1		(Vat records)
1				1		N/A
	1			1		N/A
						N/A
			1			N/A
			1			N/A
	1			1	1	Also quotes
1						Basis cost estimates (not quotes)
	1			1		
						Personal expenses as basis
			1			Deals automatic budget limit in three months time
		1	1		1	Monthly maintained
2	5	2	8	6	2	N/A

Res	Daily	Monthly	Seldom	Never	BS	AFS	BUD	Man acc	Acc adv	Comments
1				1						N/A
2		1				1			1	Accountant to advise
3				1						N/A
4				1						N/A
5				1						N/A
6				1						N/A
7		1				1			1	Annual; acc officer
8				1						N/A
9				1						N/A
10		1		Annual			1			Trial balance
11				1						N/A
12				1						N/A
13		1		Annual		1				Tax exercise
14		1		(grew out of this)						
15				1						
16				1						
17				1						N/A
18				1						N/A
19				1						N/A
20	0	0	5	15	0	3	0	1	2	N/A

employee salary or bonus decisions

Res	Daily	Monthly	Seldom	Never	BS	AFS	BUD	Man acc	Acc adv	Comments	Cost	Indus	Acc info	Perf
1				1						N/A				
2			1							Quote drives the decision	1			
3			1							Annually / ind		1		
4			1	Annually			1						1	
5			1	Annually									1	
6			1	Annually									1	
7			1	Annually									1	
8			1	Annually						Informed by peers		1		
9			1	Annually						Industry driven		1		
10			1	Annually			1			Trial balance			1	
11				1						N/A				
12			1	Twice a year						Informed by ind need		1		
13			1	Twice a year						Performance based				1
14			1	Annually						Legislatively driven		1		
15			1	Annually						Industry		1		
16			1	Annually						Industry determined		1		
17			1	Annually						Industry determined		1		
18			1	Annually						Inflation	1			
19				1						N/A				
20	0	0	17	3			2			Market determined		1		
	0	3	2								2	9	5	1

to request (or secure) an increased credit facility

Res	Daily	Monthly	Seldom	Never	BS	AFS	BUD	Man acc	Acc adv	Comments	Noth
1		1			1					ABSA standard package	
2		1			1					Annual standard procedure	
3		1			1	1				Annual standard procedure	
4				1							
5				1							
6		1		Annually	1	1		1			
7		1		Annually	1						
8		1		Once off	1	1					
9		1		Annually	1						
10		1			1						
11				1						N/A	
12		1			1						
13		1		On demand						No submission	1
14		1		Only for big jobs						No submission	1
15		1				1					
16		1				1	1			No business plan	
17		1		Periodic		1	1				
18		1		Annually	1						
19		1		Annually		1					
20	0	0	17		1	14	5	2			2
				3				0			

Res	Daily	Monthly	Seldom	Never
1				1
2			1	Annually
3			1	Annually
4			1	Quarterly
5			1	Annually
6			1	Annually
7			1	Annually
8	1			
9	1			
10	1			
11			1	Annually
12	1			
13	1			
14				1
15				1
16			1	
17	1			
18				1
19	1			
20	1			
0	8	8	8	4

Cash

BS	AFS	BUD	Base	Man acc	Acc adv	Comments
			1			N/A
	1		1			Annual checks on critical trends eg. Profit margin
	1	1	1			Annually, during budget preparation
				1		
	1					Five year comparisons/ also amongst months
				1		
	1					(VAT records)
						Detailed sales records
				1		Trial balance
				1		Also compare mix
						Excell sales records
			1			Mainly turnover figures
						N/A
						N/A
						Monitoring
	1		1			
						Not on paper
						GNLD records
						Sales only/ expenses annually
0	5	1	8	8	0	

Res	Daily	Monthly	Seldom	Never	BS	AFS	BUD	Man acc	Acc adv	Comments	Market	Cost	Other
1			1							Gut feel			1
2	1			Ongoing						Built into quotes; competition etc. informs	1	1	
3	1			Ongoing						Market determined	1		
4	1			Ongoing						Market forces/exchange rate	1		
5		1			N/A					Sensitive market	1		
6			1	Annually		1							1
7	1									Quotes of Cost Plus	1	1	
8			1	Annually				1		...and exchange rates	1	1	
9			1	Annually						Cost Plus (own calculations)	1	1	
10	1			Ongoing						Cost based	1	1	
11	1			Ongoing						Cost+market driven ind products	1	1	
12	1			Ongoing						Cost+market driven ind products	1	1	
13	1			Ongoing						Cost+markup; hourly rate for support	1	1	
14	1									Cost driven	1	1	
15			1	Annually						Labour markup	1	1	
16			1	Annually						Set by franchise	1	1	
17	1									Industry determined	1		
18	1									Negotiation	1		
19	1									Policy driven	1		
20	1									Exchange rates	1		
	13	1	6	0	0	1	1	2	0		8	9	5

Calculation of income tax due
(and tax planning in general)

Res	Daily	Monthly	Seldom	Never	BS	AFS	BUD	Man acc	Acc adv	Comments
1			1			1				Annually
2			1			1				Annually
3			1			1				Annually
4			1	Twice a year		1	1			
5			1	Twice a year		1				
6			1	Twice a year		1				
7			1	Twice a year		1				
8			1	Twice a year		1				
9			1	Twice a year		1				
10			1	Twice a year		1				
11			1	Twice a year		1				
12			1	Twice a year		1				
13			1	Twice a year		1				
14			1	Twice a year		1				
15			1	Twice a year		1				
16			1	Twice a year		1				
17			1	Twice a year		1				
18			1	Twice a year		1				
19			1	Twice a year		1				
20			1	Twice a year		1				
0	0	0	20	0	0	20	0	1	0	

Valuation of business

Res	Daily	Monthly	Seldom	Never
1			1	1
2		1		
3		1		
4		1		
5				1
6				1
7				1
8		1		
9		1		
10		1		Once off
11				1
12		1		
13				1
14				1
15				1
16		1		
17		1		
18				1
19				1
20	0	0	10	Once off
	0	0	10	10

BS	AFS	BUD	Man acc	Acc adv	Comments
	1			1	N/A
	1			1	Considered sell out at times
				1	Auditors - for share movement and ins
					N/A
					N/A
					N/A
			1		Accountant to do
					Own calculations
					2,5 times sales
					N/A
			1		
					N/A
					N/A
					N/A
	1		1		To judge justification to carry on
					Goodwill in location and low rent
					N/A
					N/A
					To change ownership
0	3	0	1	1	
				6	

Res	Daily	Monthly	Seldom	Never
1				1
2			1	
3			1	
4	1			
5		1		
6			1	
7			1	
8				1
9			1	
10				1
11				1
12			1	
13			1	
14				1
15				1
16			1	
17				1
18				1
19				1
20	1	1	8	10

BS	AFS	BUD	Man acc	Acc adv	Comments
					N/A
					See salaries
					Availability the critical factor
					See expansion
					Needs driven
					Needs driven
					Not financial
					N/A
					Needs driven
					N/A
					N/A
					Needs driven
					Necessaty
					N/A
					N/A
					Human assessment
					N/A
					N/A
					N/A
					N/A
0	0	0	0	0	

Res	Daily	Monthly	Seldom	Never
1				1
2				1
3				1
4			1	
5	1			
6			1	
7			1	
8			1	
9			1	
10				1
11				1
12		1	Weekly advertd	
13				1
14				1
15	1			
16				1
17		1		
18	1			
19	1			
20	4	2	5	9

BS	AFS	BUD	Man acc	Acc adv	Comments
					N/A
					N/A
					N/A
					Not accounting driven
					Not accounting driven
					Not accounting driven
					Not accounting driven
					Not accounting driven
					Only word of mouth
					Only word of mouth
					Stand alone
					Only word of mouth
					Self advertised
					Only word of mouth
					Franchisor function
					Argus/ show room
					Not accounting driven
					Whole driver of business
					Not accounting driven
0	0	0	0	0	

Debt collection

Res	Daily	Monthly	Seldom	Never	Credit		BS	AFS	BUD	Man acc	Acc adv	Comments
					Sales							
1		1				1						Invoices followed up
2				1								N/A
3				1								N/A
4	1					1						Age analysis
5	1			Ongoing		1						Automated system
6		1				1						Policy driven
7			1			1						Per case
8				1		1						N/A
9	1			Ongoing		1						Age analysis+strict credit control
10				1								N/A
11		1				1			1			
12				1								N/A
13				1								N/A
14		1				1						Invoice factoring
15				1								N/A
16				1								N/A
17				1								N/A
18				1								N/A
19				1								N/A
20	3	4	2	11	10	10	0	0	0	1	0	Aging system

18 Do you reflect on a annual basis (or more regularly) on the financial position and performance of your business? If yes, elaborate on how you do it.

Res	Comments	acc			
		AFS	+bud	+acc	No
1	No, not at all				1
2	Annually; study AFS, observe valued items:certain expense items + margins.	1			
3	Yes; annually and before major change in business. AFS central to this exercise	1			
4	Often i.e. at least four times a year	1			
5	Monthly and annually	1			
6	Budget exercise once a year	1	1		
7	Strictly with guidance of accountant	1		1	
8	Budgeting exercise annually	1	1		
9	Budgeting exercise annually (revised six monthly)	1	1		
10	Quarterly; using PASTEL trial balance	1			
11	Annually with accountant	1		1	
12	Annually with accountant does add value	1		1	
13	Talk through AFS and really advise on strategy for road ahead.	1		1	
14	Monthly on management accounts+annual; does change behaviour	1			
15	Not at present; do strive to do				1
16	Often do return on asset assessment and cost control	1			
17	Yes, with AFS; confirm what books told already; does change behaviour.	1			
18	Two members sit around AFS; regard as very important	1			
19	Annual ; absolutely strategic importance; change behaviour.	1			
20	No surprises; tax exercise				1
		17	3	4	3

19 Can you distinguish the parts of annual financial statements; income statement, balance sheet, cash flow statement (perhaps statement of receipts and payments)? How often do you use it?

Page 34

	Comments	I/S	B/S	CF
1	Can not distinguish, never uses.			
2	Can basically distinguish income statement and balance sheet; use only with accountant	1	1	
3	Can basically distinguish income statement and balance sheet; use only with accountant	1	1	
4	Treat as package	1	1	1
5	PASTEL post adjustment trial balance adequate			
6	Uses and understand income statement alone	1		
7	Only income statement really understood; bal sheet a little with accountants help; cash flow not	1		
8	Can distinguish income statement and balance sheet; do not know a cash flow statement	1	1	
9	Only income statement really understood; bal sheet a little with accountants help; cash flow not	1		
10	Only income statement ; balance sheet irrelevant; cash flow statement not understandable	1		
11	Income statement and monthly cash movement statement ; not balance sheet	1		
12	Income statement understandable not B/s and cash flow statement	1		
13	Never use unassisted; not really familiar with components			
14	Only income statement really understood; bal sheet a little with accountants help; cash flow not	1		
15	Only income statement really understood; bal sheet a little with accountants help; cash flow not			
16	Understand income statement and balance sheet noy cash flow statement	1	1	
17	Understand income statement only	1		
18	Only income statement really understood; bal sheet a little with accountants help; cash flow not	1		
19	Income statement ; balance sheet yes; cash flow statement not at all.	1	1	
20	Income statement ; balance sheet yes; cash flow statement not at all.	1	1	
		16	7	1

20 Do you regard the financial statements of the corporation in their **current format** as:
 simple and user friendly enough to understand properly

Res	Yes	No	Comments	
1		1	Note, no annual reflection	
2	1		For current (limited) purpose	
3	1		Fair	
4		1	No	
5		1	No	
6	1		Balance sheet not understandable ; I/S fine/ Rest irrelevant	
7	1		Balance sheet not understandable ; I/S fine/ Rest irrelevant	
8	1		Balance sheet not understandable ; I/S fine/ Rest irrelevant	
9	1		Balance sheet not understandable ; I/S fine/ Rest irrelevant	
10			Not relevant enough to comment on.	
11	1			
12		1	Not really	
13			No personal opinion; only value accountants opinion	
14		1	Need better cash orientation	1
15	1		Monthly comparisons critical though.	
16		1	Not user friendly enough	
17		1	Strong need for friendlier financial statements	
18	1		Strong need for single pager	1
19		1	Terminology; additional one pager will be welcome.	1
20	1		Need for one pager though	1
	10	8		

21 Are there certain obvious aspects of financial statements which, in your view, do not consider the specific needs of smaller businesses (eg terminology used etc.)? Page 36

Res	Terms	Basis	CF	Acc
1	N/A			
2	Some terms			
3	Not for purpose for which used			
4	Reads difficult/ do not clearly recognise own business from it. Cash departure will be better	1		
5	Format not understandable; cash basis should be point of departure	1		
6	N/A			
7	Cash flow statement senseless; balance sheet too complicated		1	
8	N/A			
9	Cash flow statement senseless; balance sheet too complicated		1	
10	No need			
11	No need, if accountant explain			1
12	Terminology			
13	No need; AFS need to confirm own assessment of financial position)			
14	Receipts and payments statements will be more helpful	1		
15	N/A			
16	N/A			
17	N/A			
18	N/A			
19	N/A			
20	N/A			
		2	3	2
				1

22 The term "turnover" or "sales", has most value to you if it includes:

Res	Inv	Cash
1		1
2		1
3	1	
4	1	
5	1	
6	1	
7	1	
8	1	
9	1	
10	1	
11	1	
12		1
13	1	
14	1	
15		1
16	1	
17	1	
18		1
19	1	
20	1	
	15	5

Real estate

23 The term "purchases", has the most value to you if it includes:

Res	Inv	Cash
1		1
2		1
3	1	
4	1	
5	1	
6	1	
7	1	
8	1	
9	1	
10	1	
11	1	
12	Monthly purchases more informative; Gross margin informative for losses	
13	1	
14	1	
15	1	
16	1	
17	1	
18		1 Real estate
19	1	
20	1	
	16	3

24 How often do you use each of the following indicators of financial performance for your business:

turnover/ sales

Res.	Daily	Monthly	Annually	Never	
1				1	
2					Only in a per job context; not a period context
3					Only per transaction context
4		Quarterly		1	Gross profit not sales
5		1			
6		1			
7				1	
8		1			
9		1			
10	1				
11	1				Daily sales target
12	1	Weekly			
13	1				
14	1				
15	1				
16		1			
17		1			
18		1			
19	1	Weekly			
20	1				
	8	7	0	3	

the bank balance

	Res.	Daily	Monthly	Annually	Never
1	1				
2	1				At least twice a week
3	1				
4				1	
5	1				(Owner value it not accountant)
6				1	
7	1				
8	1				
9	1				
10	1				
11	1				
12	1				
13	1				
14				1	
15	1				
16				1	
17	1				
18	1				
19	1				
20	1				
	16	0	0	0	4

profit (or loss) per income statement

Res.	Daily	Monthly	Annually	Never
1				1
2			1	
3			1	
4		1		
5				1
6				1
7				1
8				1
9	Six monthly	1		
10			1	Annual
11		1		
12				
13				1
14		1		
15		1		
16			1	Annually
17				1
18				1
19				1
20				1
	0	4	5	10

(In this business this differ very little from cash surplus)

For reflection

As per own management report

Informed by markup policy

Does spur action if actual differ from anticipated

To determine distribution to member

More emphasis on expense and income control

Rather chasing a markup per transaction midst discount and comp.

a cash surplus (or deficit)

Res.	Daily	Monthly	Annually	Never	
1				1	(Note that I/S in essence cash for this entity)
2				1	(Note that I/S in essence cash for this entity)
3				1	(Note that I/S in essence cash for this entity)
4				1	
5				1	
6				1	
7				1	
8				1	
9				1	
10				1	
11		1			Emphasis on debtors and creditors control
12				1	
13				1	
14				1	
15				1	
16				1	
17				1	
18				1	
19				1	
20	0	1	0	19	

another financial performance indicator? Please specify below:

Res.	Daily	Monthly	Annually	Never	
1				1	A per contract accounting system would add value considerably.
2				1	N/A
3				1	N/A
4	Quarterly	1			Movement in debtors/ creditors /inventory
5	1	Ongoing			Debtors aging
6				1	N/A
7				1	N/A
8				1	N/A
9		1			Monthly comparisons of sales and expenses
10				1	N/A
11				1	N/A
12				1	N/A
13				1	N/A
14		1			Gross margin (labour excluded)
15				1	N/A
16				1	N/A
17	1				Profit per car
18		1			Amount VAT paid
19				1	
20	1				Gross profit
	3	3	1	13	

Variety of performance indicators used per respondent

Res.	Turn	Bank	Profit	Surplus	Other	Total
1	0	1	0	1	0	2
2	0	1	1	0	0	2
3	0	1	1	0	0	2
4	0	0	1	1	1	3
5	1	1	0	0	1	3
6	1	0	0	0	0	1
7	0	1	0	1	0	2
8	1	1	0	0	0	2
9	1	1	1	0	1	4
10	1	1	1	0	0	3
11	1	1	1	0	0	3
12	1	1	0	0	0	2
13	1	1	0	0	0	2
14	1	0	1	0	1	3
15	1	1	1	0	0	3
16	1	0	1	0	0	2
17	1	1	0	0	1	3
18	1	1	0	0	1	3
19	1	1	0	0	0	2
20	1	1	0	0	1	3
	15	16	9	3	7	

25 Any other comments on indicators of financial performance?

Res	
1	The admin member expressed need for training in accounting aspects
2	No
3	No
4	Working capital critical
5	N/A
6	Debtor days critical
7	Successful matching of receipts and payments
8	N/A
9	N/A
10	N/A
11	N/A
12	N/A
13	N/A
14	N/A
15	N/A
16	Regular review of ROA
17	N/A
18	N/A
19	N/A
20	N/A

26 Is it clear to you which amounts (in the form of salary, interest on capital etc.) you can use for personal use without jeopardising the smooth operating of the business?

Q 26

Res		Yes
1	N/A - business informed by personal needs, instead of the other way round	
2	Yes, informed by daily cash flow ("monthly")	1
3	Current sources bank statements, budget and accountant	1
4	Yes, sophisticated systems	1
5	Yes, accountant can interpret records	1
6	Yes, sole member can interpret records	1
7	N/A - business informed by personal needs, instead of the other way round	
8	Yes, because of simple rule to stick to fixed salary, survival based	1
9	Yes, because of regular bank balance check	1
10	Yes, members distribution determined per I/S	1
11	Annually verified with accountants help	1
12	N/A Need informs business, rather than opposite	
13	Yes	1
14	Yes	1
15	Yes	1
16	Yes	1
17	Yes	1
18	Yes, bank statements	1
19	Yes	1
20	Yes	1
		17

Q 17 Q 17

Needs/	Acc ad	No
Cash		
		1
1		
1		
	1	
	1	
1		
		1
1		
	1	
	1	
		1
1		
	1	
	1	
1		
		1
1		
8	9	3

27 Which one of the listed three financial values are best nurtured by you and the other owners of the corporation:
(Tick only one of the three)

	Res.	Sur	Sup	Grow
1	1			
2				1
3				1
4	1	1	1	1
5				1
6			1	
7	1			
8	1			
9			1	
10			1	
11	1			
12			1	
13		1	1	1
14	1		1	1
15				1
16				1
17		1		
18				1
19				1
20	6	1	8	11

Sometimes fall back to lower values

Sometimes fall back to lower values; sometimes rise to third level

Sometimes slips back into survival mode

Personal budget is point of departure

29 Is it necessary to simplify financial statements at all

Res		Yes	No	No Op
1	No Opinion			1
2	Yes	1		
3	No Opinion			1
4	User friendlier	1		
5	Yes	1		
6	SARS require complete statements			1
7	SARS require complete statements			1
8	Yes	1		
9	Mainly simplification through education		1	
10	Presently records more relevant; perhaps a good cash based statement will change that	1		
11	No Opinion			1
12	Rather an explaining accountant		1	
13	No need; accountants tool		1	
14	To much sophistication to little simplicity	1		
15	Simpler please	1		
16	Monthly statements and education of users		1	
17	Yes, additional statement	1		
18	Yes, additional statement	1		
19	Yes	1		
20	No Opinion		4	1
		10	4	6

31 Which benefits, in your view, apply to an annual audit.

- 1 No opinion
- 2 No opinion
- 3 Grant some credibility to AFS
- 4 A spring clean for the whole firm
- 5 No opinion
- 6 No opinion
- 7 No opinion
- 8 No opinion
- 9 No opinion
- 10 No opinion
- 11 No opinion
- 12 No opinion
- 13 No opinion
- 14 No opinion
- 15 No opinion
- 16 No opinion
- 17 No opinion
- 18 No opinion
- 19 No opinion
- 20 No opinion

32 Do you think accountants (not registered as chartered accountants and auditors) can offer an adequate service to make financial statements credible for outsiders?

Res

- 1 Yes, very cost effective
- 2 Cas' not geared for personalised needs of SMEs' at affordable price.
- 3 Do not know
- 4 n/a
- 5 Yes
- 6 Yes
- 7 No Opinion
- 8 Yes
- 9 Not tested
- 10 Yes they do indeed
- 11 No Opinion
- 12 No Opinion
- 13 No Opinion
- 14 No Opinion
- 15 No Opinion
- 16 No Opinion
- 17 No Opinion
- 18 No Opinion
- 19 No Opinion
- 20 No Opinion

ANNEXURE 5

Hypothetical entity illustrating the conventional accrual model versus the Lee NRV model

FINANCIAL POSITION

FINANCIAL PERFORMANCE

	Conventional	
	Accrual-basis	1st year
	2008	2007
Assets		
Land	311	281
Plant	100	100
Supplies	25	50
Trade receivables	32	20
Cash in bank	154	111
	311	281
	266	266

	Conventional	
	Accrual-basis	1st year
	2008	2007
Revenue		
Services rendered	230	210
	230	150
Expenses		
General expenses	(155)	(145)
Depreciation	114	101
Interest expense	25	25
	16	19
	70	9

Equity		
Memb.contribution	37	29
Retained earnings	20	20
Opening Ret. earnings	17	9
Profit for the period	9	4
Distributions	48	40
	(40)	(35)
	274	252
Liabilities		
Loan	116	160
Bank overdraft	56	10
Trade payables	35	22
SARS	27	25
Distributions payable.	40	35
	311	281
	266	266

Profit before tax	75	65
Taxation expense	(27)	(25)
Profit / surplus for the period	48	40
	29	29

Notes

- 1 Values in conventional model stated at NRV to make it easier to see how the NRV differ from the conventional model.
- 2 Important to note that profit (in the NRV model) is determined as a secondary step after change in indefinite liabilities (equity) was determined in NRV terms.
- 3 The moment an item is classified as not realisable, the "equity" will be reduced.

Cash resources statements connected by statement of total cash flow as envisaged by Lee		Statement of cash Resources 2008	Total Cash Flow 2008	Statement of cash Resources 2007	Total Cash Flow 2007	Statement of cash Resources 2006
Realized cash	0	0	0	0	(32)	32
Readily-realizable (Land, supplies, receivables)	286	55	231	72	159	159
Not readily-realizable (Plant)	25	(25)	50	75	75	75
Not realisable (Specialized part of plant)	0	0	0	0	0	0
	<u>311</u>	<u>30</u>	<u>281</u>	<u>15</u>	<u>266</u>	<u>266</u>
Short term obligations (Overdraft, payables,)	158	66	92	40	52	52
Long term obligations (Loan)	116	(44)	160	(30)	190	190
Indefinite obligations (Equity on NRV basis)	37	8	29	5	24	24
	<u>311</u>	<u>30</u>	<u>281</u>	<u>15</u>	<u>266</u>	<u>266</u>
PROFIT DERIVED NRV BASED CHANGE IN INDEFINITE LIABILITIES (Equity)						
Increase in indefinite obligations	8	5	24	25	(20)	29
Distributions	40	40	(20)	(20)	(20)	(20)
Capital contribution	48	48	(20)	(20)	(20)	(20)
Profit (in NRV terms)	<u>48</u>	<u>48</u>	<u>(20)</u>	<u>(20)</u>	<u>(20)</u>	<u>29</u>

ANNEXURE 6

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Hypothetical entity illustrating that conceptually, "life earnings" equals entity cash flows before distributions to owners.

FINANCIAL POSITION	Last year	Accrual-basis		1st year
	2009	2008	2007	2006
Assets	0	311	281	266
Land	0	100	100	100
Plant	0	25	50	75
Supplies	0	32	20	12
Trade receivables	0	154	111	47
Cash in bank				32
	<u>0</u>	<u>311</u>	<u>281</u>	<u>266</u>
Equity	0	37	29	24
Memb.contribution	0	20	20	20
Retained earnings	0	17	9	4
Opening Ret. earnings	17	9	4	0
Profit for the period	70	48	40	29
Distributions	(87)	(40)	(35)	(25)
Liabilities	0	274	252	242
Loan	0	116	160	190
Bank overdraft	0	56	10	
Trade payables	0	35	22	10
SARS	0	27	25	17
Distributions payable.	0	40	35	25
	<u>0</u>	<u>311</u>	<u>281</u>	<u>266</u>

Performance statement	Last year	Accrual-basis		1st year	Page 2
	2009	2008	2007	2006	
Revenue	290	230	210	150	
Services rendered	240	230	210	150	
Profit on disposal of land	50				
Expenses	(189)	(155)	(145)	(104)	
General expenses	152	114	101	70	
Depreciation	25	25	25	25	
Interest expense	12	16	19	9	
Profit before tax	101	75	65	46	
Taxation expense	(31)	(27)	(25)	(17)	
Profit for the period	<u>70</u>	<u>48</u>	<u>40</u>	<u>29</u>	187

Reconciliation between Profit for the period and entity cash flows

	Last year	Accrual-basis		1st year
	2009	2008	2007	2006
Profit for the period	70	48	40	29
Profit on disposal of land	(50)			
Interest expense	12	16	19	9
Depreciation	25	25	25	25

	Accrual-basis				
	Cash flow statement				
	2008	2008	2007	2006	
<u>Operating activities</u>	169	33	13	22	
Profit before tax	101	75	65	46	
Profit on disposal of land	(50)				
Interest expense	12	16	19	9	
Depreciation	25	25	25	25	
Operating profit	88	116	109	80	
Supplies	32	(12)	(8)	(12)	
Trade receivables	154	(43)	(64)	(47)	
Trade payables	(35)	13	12	10	
Cash generated from operations	239	74	49	31	
Interest paid	(12)	(16)	(19)	(9)	
Tax paid	(58)	(25)	(17)	0	
<u>Investing activities</u>	150	0	0	(200)	
Disposal / Expansion Replacement	150			(200)	
Entity cash flows	319	33	13	(178)	187
<u>Financing activities</u>	(263)	(79)	(55)	210	Note
Members contribution	(20)			20	
Distributions	(127)	(35)	(25)	0	1
Loan repaid / taken up	(116)	(44)	(30)	190	
Net cash flow	56	(46)	(42)	32	
Op. cash + equivalents	(56)	(10)	32	0	
Cl.. cash + equivalents	0	(56)	(10)	32	2

Note

- 1 Distributions classified as a financing activity to achieve owners' cash flows as one total.
- 2 Bank overdraft assumed to be normal part of cash management.

FINANCIAL PERFORMANCE

Page 2

	Accrual-basis		Cash-basis	
	2008	2007	2008	2007
Revenue	230	210	187	146
Services rendered	230	210	187	146
Members contribution				
Loan taken up				
				313
Expenses	(155)	(145)	(173)	(146)
General expenses	114	101	113	97
Depreciation	25	25		
Interest expense	16	19	16	19
Land purchased				
Plant purchased				
Loan repaid			44	30
				(281)
				72
Profit before tax	75	65	14	0
Taxation expense	(27)	(25)	(25)	(17)
				32
Profit / surplus for the period	48	40	(11)	(17)
				32

Reconciliation between cash basis (deficit) / surplus and entity cash flows:

(Deficit) / surplus for period	(11)	(17)	32
Add / subtract cash flows between owners and entity:			
Members contribution			(20)
Loan	44	30	(190)
Entity cash flows	33	13	(178)

	Accrual-basis		Note
	Cash flow statement		
	2008	2007	2006
<u>Operating activities</u>			
Profit before tax	33	13	22
Interest expense	75	65	46
Depreciation	16	19	9
Operating profit	25	25	25
Supplies	116	109	80
Trade receivables	(12)	(8)	(12)
Trade payables	(43)	(64)	(47)
Cash generated from operations	13	12	10
Interest paid	74	49	31
Tax paid	(16)	(19)	(9)
	(25)	(17)	0
<u>Investing activities</u>			
Disposal / Expansion	0	0	(200)
Replacement			(200)
Entity cash flows	33	13	(178)
<u>Financing activities</u>			
Members contribution	(79)	(55)	210
Distributions	(35)	(25)	20
Loan repaid / taken up	(44)	(30)	190
Net cash flow	(46)	(42)	32
Opening balance: cash + equivalents	(10)	32	0
Closing balance: cash + equivalents	(56)	(10)	32

Notes
1 See note 1 annexure 6
2 See note 2 annexure 6

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