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Guidelines and Recommendations for Improving the Micro Entities Model of Financial Reporting

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Abstract

In most countries, micro entities have a predominant share in the total number of registered entities. Administrative relief for micro entities is lately one of the most common requirements regarding their financial reporting practices. This subject is particularly actualized with recent amendments to new accounting directive (2013/34/EU). In this context, the creation of a more appropriate financial reporting model, customized for micro entities, represents a current scientific and professional challenge. Comparing the existing financial reporting solutions in the EU and Croatia it has been noticed that for now in Croatia there is no space for simplifying regulations even though the results of empirical research confirm the need for simplification of financial reporting model for micro entities.

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Keywords: financial reporting model; accounting directive; national legislation; financial statements; micro entities; Croatia

1. Introduction

Business of micro enterprises is specific for many reasons. On the one hand, business is simpler, there is much lower volume of transactions present, owners generally completely independently manage the company, etc. Very often they have difficulties with accessing bank credit and almost no chance of financing through the capital market. In most countries, micro entities have a predominant share in the total number of registered entities. Although their business is much simpler, micro entities generally have to apply the same accounting rules as for example medium-

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sized entities i.e. entities with a much larger number of employees and much more complex business transactions. This situation causes problems in business practice, especially in the area of financial reporting.

Administrative relief for micro entities is lately one of the most common requirements regarding their financial reporting practices due to fact that costs of financial reporting exceed their expected benefits. This subject is particularly actualized with recent amendments to EU accounting directive e.g. with the introduction of the category of micro entities in the content of this most important European regulation. Each EU Member State has the task to concretize the implementation of the main provisions of the new 2013/34/EU Directive. The Directive offers Member States the possibility of self-regulation in the area of financial reporting undertakings, but in a way that provisions of national legislation are not inconsistent with the Directive.

Croatia as EU Member State had an obligation to incorporate the provisions of the new directive in the national legal framework, which was done in July of 2015. Considering the fact that typical Croatian entity is micro-sized, it is particularly important to analyze provisions concerning the possibility for simplifying the regulation of their financial reporting. In this context, the creation of a more appropriate financial reporting model, customized for micro entities in the Republic of Croatia, represents a current scientific and professional challenge. Guidelines and recommendations for its improvement are serving as a tool for realizing fundamental objectives of this research.

2. Characteristics of micro entities and their regulatory framework

Lately, financial reporting of micro entities has been the subject of discussion of many professional associations, standards creators, institutional and regulatory bodies at the international and national level. Finally, it should be noted, that this Directive is a result of ever-present need of accounting regulation simplification for these numerically significant group of the economy. Directive 2013/34/EU "*takes into account the Commission's better regulation programme, and, in particular, the Commission Communication entitled Smart Regulation in the European Union, which aims at designing and delivering regulation of the highest quality whilst respecting the principles of subsidiarity and proportionality and ensuring that the administrative burdens are proportionate to the benefits they bring*" (European Parliament & Council of the European Union, 2013).

The first question that arises is how to define micro-entities? Should only quantitative classification criteria be respected or should we consider some specifics of the economic environment in which the entity operates? Or is it sometimes favorable to use qualitative criteria in highlighting the importance of the subject, and thus on their rights and obligations arising under the criteria of classification. Practice shows that the values, which serve as a classification criteria, are changing in accordance with the circumstances and current economic conditions. The New accounting directive of the European Union (2013/34/EU) defines quantitative criteria that determine what is meant by the concept of micro, small and medium enterprises. The current criteria and the corresponding values are based on average number of employees, value of net turnover and the value of total assets (table 1).

Table 1. Classification criteria for undertakings and groups (according to accounting Directive 2013/34/EU)

Criteria/Size	Micro undertakings	Small undertakings	Medium-sized undertakings	Large undertakings	Small groups	Medium-sized groups	Large groups
	do not exceed the limits of at least two of the three			exceed at least two of the three	do not exceed, on a consolidated basis, the limits of at least two of the three		exceed at least two of the three
Net turnover	€ 700,000	€ 8,000,000	€ 40,000,000	€40,000,000	€ 8,000,000	€ 40,000,000	€40,000,000
Balance sheet total	€ 350,000	€ 4,000,000	€ 20,000,000	€20,000,000	€ 4,000,000	€ 20,000,000	€20,000,000
Average number of employees during the financial year	10	50	250	250	50	250	250

It is interesting to notice that latest amendments to the Directive require the introduction of the new size category i.e. micro entities. This category includes small legal entities that employ fewer than 10 employees, generate net