第十四届西湖国际中小企业研讨会论文集

池仁勇　郭仁源
欧阳仲建　冯懃　主编

浙江工商大学出版社

Proceedings of the Fourteenth West Lake International Conference on Small & Medium Business

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（WLICSMB2012）

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ZHEJIANG GONGSHANG UNIVERSITY PRESS

图书在版编目(CIP)数据

第十四届西湖国际中小企业研讨会论文集（WLICSMB2012）= Proceedings of the Fourteenth West Lake International Conference on Small & Medium Business（WLICSMB2012）英文 / 池仁勇等主编. — 杭州：浙江工商大学出版社，2013.6
ISBN 978-7-81140-796-9

Ⅰ.①第… Ⅱ.①池… Ⅲ.①中小企业－企业管理－国际学术会议－文集－英文 Ⅳ.①F276.3－53

中国版本图书馆 CIP 数据核字(2013)第 104257 号

第十四届西湖国际中小企业研讨会论文集(WLICSMB2012)
Proceedings of the Fourteenth West Lake International Conference on Small & Medium Business(WLICSMB2012)

池仁勇　郭元源　欧阳仲健　冯　勤 主编

责任编辑　罗丁瑞
责任校对　何小玲
责任印制　汪　俊
出版发行　浙江工商大学出版社
（杭州市教工路 198 号　邮政编码 310012）
（E-mail：zjgsupress@163.com）
（网址：http://www.zjgsupress.com）
电话：0571－88904980,88831806(传真)
排　　版　杭州朝曦图文设计有限公司
印　　刷　武汉三新大洋数字出版技术有限公司
开　　本　889mm×1194mm　1/16
印　　张　37.5
字　　数　1213 千
版 印 次　2013 年 6 月第 1 版　2013 年 6 月第 1 次印刷
书　　号　ISBN 978-7-81140-796-9
定　　价　200.00 元

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浙江工商大学出版社营销部邮购电话 0571－88804227

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PART ONE:
INNOVATION AND R & D OF SMB

Accounting and Auditing Standard Setting for Small and Medium Business: Should Other Economies Follow Lessons Learned in the United States?

Gregory S. Kordecki
(Clayton State University, USA)

Abstract: Global accounting and auditing standards have been emerging in recent years. These trends may prove promising for comparative decision making on the present health and future prosperity of businesses of all sizes. In the United States, a country which has not yet fully committed to converge with all international standards, there has been increasing interest in the perception of needs for differential accounting and auditing standards for commercial enterprises of varying sizes and other characteristics. This paper traces the development of U. S. standard setting over the past 30 years, pinpointing advantages and disadvantages to evaluating the economic outlook on various entities over this time period, and addresses parallels that seem to be emerging in other countries. Recognizing the role of accounting and auditing in the U. S. is compliance derived from sources that are not totally statutory, yet must subscribe to "rules," presents an interesting dilemma, and perhaps opportunities for the development of accounting and auditing in other countries. This paper illustrates distinct advantages, and appropriate limitations, in having a structure of standard setting bodies for accounting and auditing that meet the needs of the constituent members of the community, all the while adhering to the tenets of professionalism. Asian economies may benefit from the differential standards appropriate for small and medium business. The paper concludes with recommendations for future directions in standard setting and implementation for small and medium business financial reporting.

Keywords: accounting, auditing, China, private companies, standard setting, small business

1. Introduction

The International Accounting Standards Board (IASB) and the International Federation of Accountants (IFAC) have been leaders in attempting to promote world-wide growth in financial reporting and auditing, but are all those principles truly efficient and effective? The 21st century experiences in the United States with a bifurcation of auditing standards for public versus private companies and the creation of the Public Company Accounting Oversight Board (PCAOB) set the stage for the future establishment of auditing standards separate from the traditional Auditing Standards Board (ASB), the latter now primarily concerned with private companies, and hence significantly, the audits of small and medium business.

On the financial reporting side, the more recent recognition by the Financial Accounting Foundation (FAF) to permit a standard setting process outside of the traditional Financial Accounting Standards Board (FASB) agenda for private company reporting, is an even greater testament to the needs for recognition of specialization in standards for small and medium busines

While small and medium sized businesses are not necessarily private companies, most are, and it follows to develop a definition of private companies. A private-sector company is a non-publicly traded, for-profit business meeting the definition provided by the Accounting Standards Codification (ASC): any entity that does NOT meet any of the following conditions:

a. Its debt or equity securities trade in a public market either on a stock exchange (domestic or foreign) or in an over-the-counter market, including securities quoted only locally or regionally.

b. It is a conduit bond obligor for conduit debt securities that are traded in a public market (a domestic or foreign stock exchanged or an over-the-counter market, including local or regional markets).

c. It files with a regulatory agency in preparation for the sale of any class of debt or equity securities in a public market.

d. It is required to file or furnish financial statements with the Securities and Exchange Commission.

e. It is controlled by an entity covered by criteria (a) through (d). (ASC 105 - 10 - 20) ([1] Nicholas C. Lynch, 2012).

The need for private company GAAP or "PCGAAP" in the U. S. is demonstrated by the data corroborated by various sources that over 50% of the U. S. economy in terms of gross domestic product comprises private companies, and that in terms of the companies themselves, the figure is over 90% ([2] Marie N. Hollein, 2012). If other economies are in any way considering modeling their entity development at least partially on the U. S. experience, an understanding of how the process and conclusions of standard-setting in the U. S. would seem to be a critical part of that analysis.

Accounting practitioners are becoming increasingly frustrated with GAAP standard setting—parties associated with private companies see rules appropriate for public companies trickling down to them with additional burdens. Costs of auditing and assurance services escalate when professionals are required to have "one-size-fit-all." Users of financial statements have to mull through irrelevant disclosures to distill the quality of the reporting entity. How did this situation evolve, what is the current status, and what is the future of standard setting for private company reporting?

2. Historical Developments in the United States

2.1 Standard Setting Overview

The accounting profession is in a bittersweet position when it comes to financial reporting for privately-held companies. On the one hand, having active, authoritative bodies in place to regulate and propose updated standards for financial accounting and reporting would appear to provide objective guidance. On the other, the profession is also plagued with the existence of multiple reporting jurisdictions and the multiplicity of the authoritative bodies. In Georgia, as in most U. S. states, a wide range of private companies exist, and they can vary significantly in size and complexity.

In developed economies such as the United States, the absence of clear guidance on issues specific to some of these private companies can make for painstaking financial reporting, and in some cases, additional effort in rendering audit and other attest services. Those who favor specialized reporting for private entities argue that public company financial reporting and disclosure is focused on compliance with the United States SEC and federal regulations. When the same accounting standards are applied to private concerns, the orientation to the user market is lost. The user needs of private companies can be different from the public companies.

The dichotomy that emerges between the need for accounting principles for different types of entities, sometimes misleadingly identified as "big GAAAP v. little GAAP," is one of increasing interest both theoretically and practically. Private company financial statement users such as owners and bankers, insurers and venture capitalists, may not be provided with the most useful information about private companies through the "usual/typical" financial reporting standards followed by public companies. In addition, financial reporting and disclosures required of public companies may not be cost effective for private companies.

2.2 Evolution of the Split

U. S. GAAP emerged with the industrial revolution and provided a platform for financial reporting that almost looked like "one size 'could' fit all." Rapid economic expansion following World War II, led to a flurry of merger and acquisition (M & A) activity, and the voluntary committees of the American Institute of CPAs (AICPA), the Committee on Accounting Procedure, and subsequently, the Accounting Principles Board, were not equipped to deal with the increasing scope and scale required. The AICPA's own *Report of the Study on Establishment of Accounting Principles* in 1972 resulted in the creation of independent process of standard setting through the Financial Accounting Foundation (FAF) and its nongovernmental standard setting group, the Financial Accounting Standards Board (FASB) ([3] AICPA, 2010). While a few differential reporting options were allowed to exist, primarily through disclosures such as earnings per share, business segments and leases, the authoritative voice of the FASB dictated requirements for generally uniform reporting requirements for all firms.

Tab. 1 Recent Historical Developments

Date	Item	Sponsoring Organization(s)
1972	Wheat Committee Report issued	AICPA
2005	Castellano Report issued	AICPA
2006	FASB Report—comments invited	FASB
2007	Private Company Financial Reporting Committee created	AICPA/FASB
2009	Blue Ribbon Panel formed	AICPA/FAF/NASBA
2011 January	Blue Ribbon Panel Final Report released	AICPA/FAF/NASBA
2011 October	Private Company Standards Improvement Council Plan exposed	FAF
2011 October	AICPA Council Resolution—"all options" to be considered	AICPA
2012 January	Comment Letters submission on Improvement Council concluded	FAF
2012 March	Roundtables on Improvement Council concluded	FAF

The accompanying table (1) illustrates that momentum builds with another AICPA study, the Castellano Report, *Private Company Financial Reporting Task Force Report*, in 2005. The FASB responded in 2006 with its Invitation to Comment, *Enhancing the Financial Accounting and Reporting Standard-Setting Process for Private Companies*. The AICPA and FASB jointly initiated the *Private Company Financial Reporting Committee* in 2007. The AICPA Council in October 2009 voted strongly in support for GAAP differences for private companies, and then in December 2009, along with FAF and the National Association of State Boards of Accountancy (NASBA), formed the 18-member Blue Ribbon Panel on Financial Reporting ([4] AICPA, 2011). That body issued its report in January 2011, supporting a new separate standard setting body, but the FAF's issuance in October of the same year of *Plan to Establish the Private Company Standards Improvement Council* (PCSIC) still proposed an advisory body reporting to the FASB ([5] Financial Accounting Foundation, 2012). Comment letters were due in January of 2012, and the FAF followed with four roundtables throughout the United States, concluding in March, 2012 ([6] Gregory S. Kordecki and Maria L. Bullen, 2012).

The sponsoring organization column in the table is enlightening as it shows how the shift has occurred from AICPA and essentially State Society involvement, toward the more federalist approach of the FAF. The AICPA Council resolution in late 2011 charged that the Improvement Council as proposed would not resolve the systemic problems that have increased since the 1970s. Other arguments to support the AICPA position stressed the unique needs of private companies and their financial statement users. Being under the domain of the FAF is not the issue as much as being under the FASB; FASB approval of a separate board's actions is seen as defeating the whole concept of separatism.

2.3 Open Debates

In its initial roundtable, held in Atlanta, Georgia, on January 18, 2012, the FAF cited concerns with bright line distinction between "big GAAP" and "little GAAP." Other voices argued on the basis of financial statement user needs, not necessarily company size. The FAF concern of schism between "little GAAP" and "big GAAP" is the Trustees' view that markets and the accounting profession will be dominated if any significant movement toward separate boards is pursued. Strong alternative views, including those of state CPA societies and the AICPA, pointed to the need of serving smaller and mid-size entities without overall sacrifice in financial reporting. The FAF arguments of excessive costs in the bifurcation in standards and complexity are not well-founded.

Many constituents believe that appropriately developed differential sets of GAAP would be better than what we have now. The benefit/cost test would have to be applied. It is clearly evident in the US domestic economy that selective differential accounting for tax v. financial reporting is good. The modifications in the Blue Ribbon Panel recommendations would be a good thing, because the GAAP would be appropriate to the reporting entity. If businesses find formal financial reporting too costly, they will urge bankers and other users to accept tax returns as a substitute for properly prepared, and appropriately attested to, financial statements.

Will two sets of GAAP confuse users and result in less useful financial statements to those users? Most users of financial statements have some minimum level of sophistication. If the base pronouncements are essentially similar, then various interpretations and practice implementation guides would be able to assist users and preparers on differences, just as being done today on EPS, segment reporting, and pension disclosures. The Blue Ribbon Panel recommendations concluded that the information to the users will be far more, rather than less, useful ([7] Report. . . Blue-Ribbon, 2011).

Would differential standards for private companies take longer to be created under a separate Board on under the FASB? The PCSIC proposal contained constraints that would create a structure that allows for deliberation, but could also lead to delay—such as acting on key issues only four to six times per year. A separate board or committee autonomy, of course, could accelerate decision making but this would be subject to board organization, authority, and funding. With over three thousand responding affirmatively to the Blue Ribbon Panel's January, 2011 report, the expectation was reasonable for the Plan to call for the creation of a fast-acting, private company focused, separate board.

2.4 Is the FAF Plan Viable?

Although the FAF's Plan to improve standard setting for private companies made some progress, many believe it did not go far enough to create an independent, authoritative standard setting board for private companies. A number of constituents believed that the proposed Private Companies Standards Improvement Council (PCSIC) would essentially report to the FASB—and not providing any substantive change from the previous committee structure, and therefore if the proposal is made final, would not yield an efficient outcome for real progress in solving the private company standard problems.

Other countries have gone to two or more sets of GAAP. For example, the UK provides reporting relief for smaller entities. In Canada, private entities are given the choice of applying either full International Financial reporting Standards (IFRS) or a new GAAP. Would two sets of GAAP make initial public offerings (IPOs) more difficult? If an entity has been relying on some alternative and reduced form of accounting and reporting prior to IPO, then additional costs will be incurred. Reconciliations can be derived, and this is an expected cost in capital market formation. The FASB should continue to do what it does best—provide standards for public companies—permitting the markets in private arenas to flourish under appropriately set standards.

2.5 Review Comments

The approach supported by many constituents of the Blue Ribbon Panel was to make private company standards different as necessary and appropriate from the required generally accepted accounting principles (GAAP) standards for public companies—an "exceptions approach" rather than starting over to develop totally new standards for private companies.

In response to the Plan for the PCSIC, over 7,000 general comment letters were received by the FAF using standard template language supporting the AICPA's position. Another 299 detailed comment letters were received, with most again supporting the AICPA and providing detailed rationale. Some of the issues that these respondents raised are included in Table (2).

Tab. 2 Extended Issues in Plan for PCSIC

Issue	Statement of the Issue
1	Reporting structure should be independent of FASB
2	International financial reporting is a consideration
3	AICPA should be able to provide advisory input
4	User needs are more important than preparer or auditor needs
5	Transition of entity from private to public is complex and costly
6	Audit fees on private entities will rise as result of big GAAP
7	PCSIC will cause a drag on time for private standard setting
8	Reporting structure should be independent of FASB, but should be responsible to the FAF

Will there be a new perspective from the FAF/FASB? From a review of what the FAF has commented in its first post-implementation review—that on FIN 48 (Uncertainty in Income Taxes) where the focus is almost exclusively on public entities—it appears not. However, the FASB in March, 2012 announced the creation of an agenda project on defining "Nonpublic Entities," This is a step in the right direction. The FASB staff promises to develop a Private Company Decision-Making Framework to assist the Board in making decisions for prospective modification of recognition, measurement, presentation, disclosure, effective dates and transition methods. Even though FASB-based, hopes are high that a discussion document for public comment containing a realistic standard setting platform for private companies will be issued in 2012 or 2013.

2.6 Arrival at Working Arrangement in the United States

In its final deliberations, the FAF made improvements to the standard setting body, now identified as the Private Company Council (PCC) which appears to provide four major takeaway's consistent with the AICPA's views:

1. Chair of the PCC will not be a sitting board member on the FASB—a win for greater independence.
2. A more with responsive PCC with fewer members—9 to 12 rather than 11 to 15.
3. Issues addressed on a timelier basis with minimum of 5 meetings per year rather than 4.
4. FAF's continual oversight and then a 3-year sunset review rather than absolute FASB control. ([8] Why the AICPA. . . , 2012)

The FAF was quick to point out that controls were still in place, but that the mechanism of the FASB will be clearly one of "endorsement," rather than "ratification," of the PCC's work, and that the establishment of a special purpose committee of the Trustees of the FAF, the Private Company Review Committee, will have primary oversight over the PCC ([9] FAF News Release, 2012).

3. Intricacies of Other Economies

3.1 Various Countries World-Wide

Emerging markets, including those in China, may be slow in arriving at accountability maturity, as long as low levels of disclosure persist ([10] Marc J. Epstein, 2012). Brazil seems to out-perform China on application of state-supported companies' profitability and innovation; however, China's score has steadily risen on the global competitiveness Index, while the score of U. S. has dropped in recent years ([11] Joshua Kurlantzick, 2012).

Tab. 3 SOE Assets (data drawn from Kurlantzick, 2012)

	2002	2010
Total assets of China's 121 largest state-owned enterprises	$ 360 Billion	$ 2.9 Trillion

As the accompanying table (3) illustrates, investments in China state-owned enterprises have significantly increased in recent years.

"One size does not fit all" in either the United Kingdom or New Zealand. In the U. K. , its Accounting Standards Board (ASB) has arrived at a 3-tier system ranging from those listed on exchanges to medium-sized, down to smaller entities, while the New Zealand External Reporting Board (XRB) separates entities on the basis of public accountability, with significantly more disclosure for the large issuers ([12] Judith A. Kamnikar, Edward G. Kamnikar, and Ashley Burrowes, 2012).

Millions of companies—more than 95% of the companies in the world—are eligible to use IFRS for SMEs, but only 45,000 listed companies on the 52 largest stock exchanges in the world would meet the design of the full SMEs according to the IASB's own *A Guide to the IFRS for SMEs*. The following table (4) provides some summary numbers on the importance of providing for a financial reporting mechanism for private-sector enterprises:

Tab. 4 Private Companies (data drawn from Kurlantzick, 2012)

Country	Private-Sector Enterprises
United States	28 million
Europe	28 million
United Kingdom	4.7 million
Brazil	6 million

Brazil has to its advantage an active Institute of Independent Auditors (IBRACON), which has been instrumental in the implementation of IFRS for SMEs, and since many of the country's entities are very small, the decision to allow adoption of this alternative set of GAAP provides for reduced complexity, and greater transparency, comparability, and efficiency ([13] Gary James, 2011). Similarly, in Iran, there are many small operating entities, most of which do not enjoy an appropriate financial information system, and suffer from ineffective and inefficient accounting ([14] Fateme Soghra Yaghubi, Mohammad Ali Moradi, and Mehrdad Mazaheri, 2011).

Lawrence Herman writes that the Canadians' use of private-sector standards and best practices is really an extension of European medieval *lex mercatoria*, a major practice and increasing factor in international business ([15] Lawrence Herman, 2012). His thesis continues with the argument that in the medieval trade community the fragmentary and obsolete rules of feudal and Roman law because those were not responsive to local and international commerce. What then arose was a creation by merchants of a "superior law."

The argument can be extended—pure private sector rule making exists to the extent that the International Financial Reporting Standards (IFRS) generated by the IASB are adopted by more and more countries. As one pundit points out, this is a growing trend in the delegation of regulatory authority from governments to a single private-sector body ([16] V. Haufler, 2005). Then, drawing upon both Herman and Haufler, the further argument surfaces that several private-sector bodies may be even more advantageous than only one from a consortium of centralized governments: the implication being that "one size does NOT fit all," and that the needs of the emerging small business otherwise may still be neglected.

World economic growth is concentrated in key developing countries, especially the "BRIIC" nations of Brazil, Russia, India, Indonesia, and China. Foreign direct investment in China for 2011was $124 billion, increasing 8% over the prior year ([17] Michael Schuman, 2012). Extension of legal and perhaps accounting governance mechanisms from an Anglo-American context to these economies may not be the most effective track ([18] Carcello, Hermanson, and Ye, 2011). How should a prosperous economy proceed if it has the ability to structure its own accounting and auditing standards?

3.2 Opportunities in Asia and Especially in China

Historical development in China of GAAP can be traced in the immediate short run to the development of the founding of the People's Republic of China (PRC) in 1949, and the requirement that resources essential to production be garnered under state-owned enterprise (SOE) system. Departures from this tradition came in 1993 with the assistance of Deloitte Touche Tohmatsu as consultant to the Chinese government ([19] Venus Ibarra and Martha G. Suez-Sales, 2011). Numerous exposure drafts of standards for "Chinese Accounting Standards" were published and then in 2001 the Ministry of Finance (MOF) issued a new comprehensive "Accounting System for Business enterprises" seeking to provide comparability among enterprises. Accordingly, China's development of standards was very methodical and deliberate, including