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Analysis related to number of small and medium-sized companies respecting accounting legislation changes

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Abstract

In order to completely adjust to the European Union's accounting legislation, from January 2016 new Accounting law will bring certain changes in Croatian accounting system. Noticeable change is a new size classification system which includes micro-entities. By adopting new classification system in Croatia, total number and proportion of large companies decreased, and the number of medium-sized companies increased by widening the range thresholds. Nevertheless, as expected, the greatest proportion of companies in Croatia will be micro-entities.

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1. Introduction

In the European Union Member states micro, small and medium-sized companies (SMEs) represent the nucleus of business and economy environment, making more than 99% of total number of companies. Within the SMEs segment micro-entities have the largest proportion which represent the simplest form of business, in most cases poorly diversified, and limited in context of development, interest of stakeholders, organizational structure, and management strategy. Those companies are often deprived from an aspect of financing possibilities. The European Union is aware of the importance of those companies which represent 'the backbone of Europe's economy'. The European Commission considers SMEs as "key to ensuring economic growth, innovation, job creation, and social integration in the EU" (The European Commission, 2015). In 2006 the Commission initiated simplification of

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accounting and auditing for SMEs. The initiation resulted with the elaborate which includes synthesis of the received reactions where five different measures had been identified in the communication with the aim of reducing the administrative burdens, notably for small and medium-sized entities: (1) introduction of 'micro-entities', (2) trespassing the thresholds for SMEs, (3) relief from publication requirement for small entities, (4) extension of exemption for companies without particular external user, (5) simplification for all companies (European Commission, Synthesis of the reactions received to the Commission communication on a simplified business environment for companies in the areas of company law, accounting and auditing (COM(2007)394), 2007, pp. 10-13). Leading with those facts, the European Commission makes appropriate efforts with a goal to ease SMEs operations in context of improving access and funding availability. New accounting Directive 2013/34/EC is focused on simplifying reporting and disclosure requirements, and to the reduction of administrative burdens resulting from the exemption from the publication requirement, especially for micro-entities.

2. Accounting legislation in Croatia before and after the European Union accession

From the beginning of Croatia's independence, accounting practice has had several waves of regulation changes. The first Accounting law was introduced in 1992, and it was in force for the next 13 years. The content of the law was fairly narrow. According to its regulations, companies in Croatia were classified into three classes (small, medium-sized and large), and all of them were required to use International Accounting Standards (IAS) in preparing the annual financial statements. Financial statements included balance sheet, income statement, statement of changes in financial position and notes to financial statements. Small companies were not required to prepare statement of changes in financial position. In 2005 new Accounting law was introduced. It could be said that the main change comparing to previous law was excluding content and structure of annual financial statements from the law. Also, statement in changes of ownership equity was added to the set of financial statements. Important element of the new law was the establishment of the Board for Financial Reporting Standards which replaced Croatian Board for Accounting and Accounting Standards. Related to that, the Board become responsible for translating and publishing International Financial Reporting Standards in Croatia. Not long afterwards in 2007 new Accounting law was ratified. Next to International Financial Reporting Standards used by large and listed companies, the new law introduces the Croatian Financial Reporting Standards developed for the small and medium-sized companies by the Board.

By accessing the European Union, Croatia was required to adjust to the European legislation system. Those adjustments in the field of accounting will be completely accomplished with the new Accounting law (NN No. 78/2015), the Regulation on a structure and content of financial statements (NN No. 96/2015), and the Croatian Financial Reporting Standards (NN No. 86/2015), which enters into force from 01 January 2016.

Framework of accounting legislation in the European Union before 2013 was based on Fourth Council Directive 78/660/EEC from 1978 and Seventh Council Directive 83/349/EEC from 1983. Fourth Directive was regulating issues of presentation and content of annual statements, the valuation methods in respect of companies with limited liability. Seventh Directive was regulating conditions for the preparation of consolidated statements. In 2011, with the goal to simplify and modernize the existing Accounting Directives proposal of new Directive was published. After two years of discussions, all necessary procedures, and after transmission of the draft legislative act to the national parliaments, in June 2013 the European Commission has adopted new Regulation (EU) No 610/2013 and Directive 2013/34/EU on the annual financial statements, consolidated financial statements and related reports of certain types of undertakings. The Directive is primarily intended for companies with limited liability that prepare non-IFRS financial statements. It gives important direction on reporting by such companies.

3. Particularities of the micro, small and medium-sized entities

In order to simplify requirements for SMEs, and in accordance with Directive 2013/34/EC regulations, the member state is allowed to exempt micro-entities from the obligation to present '*Prepayments and accrued income*' and '*Accruals and deferred income*'. Also, exemption can be made referring to the obligation to draw up notes to the financial statements in accordance with specified content of the notes to the financial statements related to other types of undertakings (*Article 16 of the Directive*), the obligation to prepare a management report, and to publish annual financial statements in accordance with simplified publication requirements for SMEs. In addition to that member state may permit to draw up only an abridged balance sheet and profit and loss account, and also shall not

permit or require the application of alternative measurement basis of fair value. Additionally, regarding the simplified operations requirements and business opportunities, International Accounting Standards Board (IASB) in order to meet the needs and capabilities of small and medium-sized companies, in 2009 designed less complexed and shortened International Financial Reporting Standards for Small and Medium-sized Entities (IFRS for SMEs). Also, the IASB published 'A Guide for Micro-sized Entities Applying the IFRS for SMEs' which accompanies the Standards. The Guide extracts publication, disclosure, recognizing and measuring requirements without modifying any of the accounting principles, focusing on probable needs of typical micro-entities (International Accounting Standards Board, 2013, p. 4).

In Croatian Accounting law, entering into force from the beginning of 2016, there are no noticeable simplifications on reporting and disclosure requirements for the SMEs. Micro, small and medium-sized companies in Croatia are obligated to prepare and present annual financial statements by applying the Croatian Financial Reporting Standards. In accordance with the law regulations they are required to prepare balance sheet, income statement and notes to financial statements. They are not obligated to prepare statement of comprehensive income. Additionally, micro and small entities are not required to prepare annual management report, but they are obligated to indicate the information on reacquisitions of the own equity instruments in the notes. Also, they are not obligated to carry out statutory audits, as opposed to medium-sized companies. Medium-sized entities are obligated to prepare annual management report, but simplified version which does not include non-financial ratios. It is interesting to notice that the Croatian Financial Reporting Standards (version from the year 2015) do not point out any exemptions for micro-entities. Those standards are designed for SMEs, but there are no special additional simplification for the micro-entities. Although they represents simplified version of IFRS, instead of reduction and simplification, the new version from 2015 is additionally expanded, especially relating to the consolidation issues and disclosure requirements.

4. Classification of companies in the European Union and Croatia

In order to reduce obligations regarding financial reporting and administrative burdens, and referring to the policy 'think small first', proposals for simplification of Fourth Council Directive appeared. Emphasizing the importance and number of the smallest companies in the European Union as a creator of new jobs, innovations, entrepreneurship, and in order to encourage new start-ups, the European Commission introduced the concept of micro-entities, as subjects that should have less complex administration and reporting obligations. In that context there are two documents which are important in establishing the definition of micro-entities. The first document is *Commission Recommendation (2003/361/EC) concerning the definition of micro, small and medium-sized enterprises* which defines micro-entity as "an enterprise which employs fewer than 10 persons and whose annual turnover and/or annual balance sheet total does not exceed EUR 2 million" (The Commission of the European Communities, 2003, Article 2).

The second document important for designing the definition of micro-entities is *Communication from the Commission on a simplified business environment (COM(2007) 394)* which is not published in the Official Journal of the European Union. The Commission proposal includes introduction of a new category called 'micro-entities' defined as companies with less than 10 employees, balance sheet total below 500.000 EUR, and net turnover below 1.000.000 EUR (European Commission, Synthesis of the reactions received to the Commission communication on a simplified business environment for companies in the areas of company law, accounting and auditing (COM(2007)394), 2007, p. 11).

Table 1: Classification criteria for undertaking in European Union according to Directive 2013/34/EU

Classification criteria	Micro-undertakings	Small undertakings	Medium-sized undertakings	Large undertakings
Balance sheet total	< 350.000 EUR	< 4.000.000 EUR (6.000.000 EUR)	< 20.000.000 EUR	> 20.000.000 EUR
Net turnover	< 700.000 EUR	< 8.000.000 EUR (12.000.000 EUR)	< 40.000.000 EUR	> 40.000.000 EUR
Average number of employees	< 10	< 50	< 250	> 250

Source: (The European Parliament and the Council, 2013)

Detailed statistical information, estimations and analysis have been given in the report on an *Evaluation of*

Thresholds for Micro-Entities which has been prepared in the context of possible changes of the Fourth Accounting Directive by the Centre for Strategy and Evaluation Services (CSES) in 2008. The report includes sensitivity analysis of changes of the number of companies related to increasing and reducing the employment and the turnover thresholds (Centre for Strategy & Evaluation Services LLP, 2008). Finally, as a result of numerous consultations, analysis, and discussions the new accounting Directive 2013/34/EU has been published. According to Directive 2013/34/EU, criteria for classifying companies have not been changed, and include balance sheet total, net turnover, and average number of employees during the financial year (to be classified into one of the classes companies have to meet two of three criteria). New classification classes include micro-undertakings, small undertakings, medium-sized undertakings, and large undertakings (The European Parliament and the Council, 2013, Article 3).

The Directive 2013/34/EU permits for the member states to increase the thresholds for the small undertakings categorization, but those thresholds shall not exceed 6 million EUR for the balance sheet total and 12 million EUR for the net turnover (*Table 1*).

Table 2: Classification of small companies in Croatia from 1992 to 2015 (1 EUR = 7,62 HRK; October 31, 2015)

Small companies	1992	2005	2007	2015
Net turnover	< 2.045.167 EUR	< 7.020.000 EUR	< 8.450.000 EUR	< 7.800.000 EUR
Balance sheet total	< 1.022.583 EUR	< 3.510.000 EUR	< 4.225.000 EUR	< 3.900.000 EUR
Average number of employees	< 50	< 50	< 50	< 50

Source: Accounting law (NN no. 90/1992, Article 16); Accounting law (NN no. 146/2005, Article 17); Accounting law (NN no. 109/2007, Article 3); Accounting law (NN no. 78/2015, Article 5)

Accounting legislation in Croatia from year 1992 includes classification of companies into three size classes taking into account net turnover, balance sheet total and average number of employees. Stated classification criteria are in a correspondence with the European legislation. During the last 23 years changes of accounting regulations included changes of size criteria thresholds, which reflected to changes in the number of companies in the particular size class. *Table 2* and *Table 3*² show thresholds changes of classification criteria for small and large companies in Croatia from 1992 to 2015.

By observing tables 5 and 6 it can be noticed that thresholds have been dynamic over the last 23 years. The largest change and leap of thresholds can be noticed in the Accounting law from 2005. Criteria values of the thresholds were more than tripled in 2005 compared to the law from 1992. New legislation from 2007 resulted with further increase of criteria thresholds. By increasing thresholds more companies were included in small and medium-sized companies, and as a result of that, number of large companies was reduced.

Table 3: Classification of large companies in Croatia from 1992 to 2015 (1 EUR = 7,62 HRK; October 31, 2015)

Large companies	1992	2005	2007	2015
Net turnover	> 8.180.666 EUR	> 28.080.000 EUR	> 33.800.000 EUR	> 39.000.000 EUR
Balance sheet total	> 4.090.333 EUR	> 14.040.000 EUR	> 16.900.000 EUR	> 19.500.000 EUR
Average number of employees	> 250	> 250	> 250	> 250

Source: Accounting law (NN no. 90/1992, Article 16); Accounting law (NN no. 146/2005, Article 17); Accounting law (NN no. 109/2007, Article 3); Accounting law (NN no. 78/2015, Article 5)

Among other adjustments and changes, significant change in the new Accounting law is adding micro-entities to the size classification (*Table 4*). Directive 2013/34/EU prescribes maximum thresholds of criteria for classifying micro-entities which are adopted by the new Croatian Accounting law (1 EUR = 7,43 HRK). As a result of the European legislation adoption, thresholds of net turnover and balance sheet total for large companies are increased compared to the Accounting law from 2007. That ends with more rigid benchmark for entering entities into class of large companies. As opposed to that, thresholds of net turnover and balance sheet total for small companies are decreased.

² It is important to emphasize that recalculations from Croatian Kuna to Euro have been conducted by using currency exchange rate of 7,62 HRK for 1 EUR which resulted with certain differences between thresholds in Croatian Accounting law (NN br. 78/2015) and Directive 2013/34/EU (in case of currency exchange rate of 7,43 HRK for 1 EUR there would not be differences).

Table 4: Classification of micro-entities in Croatia and in the European Union (1 EUR = 7,62 HRK; October 31, 2015)

Micro-entities	Croatian Accounting law (NN br. 78/215)	Directive 2013/34/EU
Net turnover	< 676.000 EUR	< 700.000 EUR
Balance sheet total	< 338.000 EUR	< 350.000 EUR
Average number of employees	< 10	< 10

Source: (Hrvatski sabor, Zakon o racunovodstvu (NN no. 78/2015), 2015) (The European Parliament and the Council, 2013)

As a consequence of those changes lower and upper thresholds for medium-sized companies are widen, which should result with increase of the number of those companies. In the new classification system number of small companies will significantly decrease, by relocating majority of companies into new class of micro-entities.

5. Analysis of changes in number of companies related to the criteria of size classification

Table 5 shows a total number of active enterprises in the European Union and separately in Croatia for the year 2012. Proportion of active companies in Croatia represents 0,33% of total number of active companies in the European Union. Almost 90% in the European Union and over 80% of active enterprises in Croatia have between 0 and 4 employees. While in the European Union over 55% of enterprises doesn't have employees, in Croatia that proportion is about 32%. Majority of enterprises in Croatia employs between 1 and 4 employees. In addition to that, higher proportion of active enterprises in Croatia (8,26%) compared to the proportion in the European Union (5,96%) has more than 10 employees. Nevertheless, if observed by the number of employees, it can be undoubtedly concluded that the companies employing less than five employees, and which are probably classified as micro or small enterprises considering only employees number, represent the most important segment of the European economy sector.

Table 5: Population of active enterprises in the European Union (28 countries) and Croatia in 2012 by size class

Number of employees	Croatia		European Union (28 countries)	
	Number	Proportion	Number	Proportion
Zero	47.094	31,86%	14.240.398	55,53%
1 to 4 employees	74.521	50,42%	8.275.279	32,27%
5 to 9 employees	13.980	9,46%	1.593.315	6,21%
10 employees or more	12.203	8,26%	1.533.471	5,98%
Total	147.798	100,00%	25.642.461	100,00%

Source: (European Commission, Structural business statistics - Database, n.d.)

Publication of Financial agency (Financijska agencija, 2015) include total of 104.470 companies in Croatia that have deliver its annual financial statements for a disclosure as shown in Table 6. As reported in the publication, small companies have the largest share of 98,49% in the total number of companies in Croatia in 2014, following by medium-sized companies with the share of 1,17%, and, as expected, the large companies have the smallest proportion (0,29%). Changes in accounting regulations in Croatia include new category of micro-entities which took over the largest share of companies in Croatia in 2014 (89,28%), leaving category of small companies with share of only 9,16%. Decrease in the number of small companies is a result of double effect (new category of micro-entities and decreasing thresholds of net turnover and balance sheet total for small companies). In addition to a decrease of the thresholds for small companies, thresholds of net turnover and balance sheet total for large companies are increased. Those changes resulted in the increase of medium-sized companies' number for 101 company, or by 8,27%. As opposed to that, share of large companies decreased from 0,34% to 0,29%, i.e. 46 companies that were large in next period will become medium-sized companies, which represents a cutback of the large companies for almost 13%.

Table 6: Number of companies in Croatia in 2014 according to classification criteria from 2007 and 2015

Number of companies in Croatia in 2014	TOTAL	Micro-entities	Small companies	Medium-sized companies	Large companies
Classification methodology 2007	104.470	/	102.895 (98,49%)	1.221 (1,17%)	354 (0,34%)
Classification methodology 2015	104.470	93.274 (89,28%)	9.566 (9,16%)	1.322 (1,27%)	308 (0,29%)
Absolute difference (Δ 2015-2007)		93.274	-93.329	101	-46

Source: (Financijska agencija, 2015)

Total number of companies included into further analysis is 112.142³. The number of companies in Croatia in 2014 decreases with employment size. Majority of companies in Croatia (50,09%) have from 1 to 5 employees, and additional 31,83% has no employees. According to that, for more than 80% of the companies in Croatia the maximum number of employees is five. More than 95% of companies in Croatia in 2014 employs up to 20 employees. Excluding from the analysis all other criteria, it can be seen that SMEs sector in Croatia represents 99,67% of total number of companies.

Table 7 shows sensitivity analysis of distribution and impact on the number of companies related to different employment thresholds, in case the employment was the only criterion. By conducting sensitivity analysis and changing the lower threshold from 10 to 5 employees, number of entities falling into that class would be decreased for 9.314 companies or by 8,31%. As opposed to that, by doubling thresholds for micro-entities up to 20 employees, number of companies increases for 5.579 or by 4,97%, i.e. share of micro-entities would increase from 90,23% to 95,20%. If the micro-entities were defined as companies with zero employees, they would have the share of only 31,83%. By analysing total segment of SMEs, it can be noticed that there is a low level of sensitivity to employment threshold change from 50 to 300 employees, i.e. proportion range from 98,16% to 99,73%. Changing the employment threshold for large companies from more than 200 to more than 500 results with change of proportion in total number of companies from 0,41% to only 0,14%. If the threshold is decreased from 250 to 200 employees, number of large companies increases for 127 companies or for more than 34%. Opposed to that, if the threshold is increased from 250 to more than 300 employees, number of companies decreases for 69 companies or 18,65%.

Table 7: Sensitivity analysis of distribution of companies in classes related to number of employees

Micro-entities		SMEs		Large companies	
Number of employees	Number of companies	Number of employees	Number of companies	Number of employees	Number of companies
0	35.700	< 50	110.073	> 201	497
< 5	91.871	< 200	111.645	> 251	370
< 10	101.185	< 250	111.772	> 301	301
< 20	106.764	< 300	111.841	> 500	153

Source: Authors' calculation using data gather from Financial agency (date: October 28, 2015)

As the net turnover threshold decreases, the share of companies rises significantly. The largest concentration of the companies, with more than 70% of total number of companies, realizes less than 1 million HRK of net turnover. Majority of companies in Croatia in 2014, more than 90%, realized less than 5,2 million HRK of net turnover, and 98,85% of them realized up to 60 million HRK of net turnover. Only 0,04% of companies in Croatia realized more than 1,5 billion HRK of net turnover.

Table 8: Sensitivity analysis of distribution of companies in classes related to net turnover

Micro-entities		SMEs		Large companies	
Net turnover (in million HRK)	Number of companies	Net turnover (in million HRK)	Number of companies	Net turnover (in million HRK)	Number of companies
< 1	78.550	< 60	110.852	> 150	530
< 3	95.210	< 100	111.361	> 260	296
< 5,2	100.966	< 300	111.900	> 300	242
< 10	105.618	< 600	112.015	> 600	127

Source: Authors' calculation using data gather from Financial agency (date: October 28, 2015)

In case if net turnover was the only criterion, high sensitivity of the number of companies can be noticed by changing the level of net turnover. If the lower threshold for micro-entities would be decreased from 5,2 million HRK to 3 million HRK, number of companies included in that class would be reduced for 5.756 companies, and in

³ Although the source for previous analysis and additionally collected data is Financial agency, possible changes may be result of a time disproportion among used publication from June of 2015 and data collected from October 2015.

case of increasing the threshold to 10 million HRK, number of micro-entities would be higher for 4.652 companies (Table 8). It can be concluded that micro-entities have approximately the same sensibility to change of thresholds to lower or upper level. Changing the threshold for total segment of SMEs from 300 to 100 million HRK, or to 600 million HRK, reduces the number of companies for 539 in case of lowering the threshold, or increases its number for 115 in case of higher threshold. If the threshold of net turnover for large companies would be changed to 600 million HRK, the number of entities in that class would be almost halved, with proportion of only 0,11% of total number of companies in Croatia in 2014.

Over 66% of companies in Croatia has balance sheet total below 1 million HRK. Another 14% of companies has balance sheet total between 1 and 2,6 million HRK, which altogether makes proportion of 80% of companies in Croatia with balance sheet total up to 2,6 million HRK. Significant proportion of companies has balance sheet total between 2,6 and 10 million HRK (12,36%). Following class from 10 to 100 million HRK takes proportion of another 6,55%, which altogether represents proportion of 98,92% of total number of companies in Croatia with balance sheet total below 100 million HRK.

Conducted sensitivity analysis in Table 9 shows changes in the number of companies related to changes of the balance sheet total threshold, taking all other items unchanged. As in previous two cases, the largest sensitivity in number of companies is present in the case of micro-entities. Lowering threshold from 2,6 to 1 million HRK results with reduction for 15.633 companies (17,42%), and increase of the threshold to 5 million HRK results with increase of companies for 7.973 or by 8,89%, which can be considered as a significant change. In case of SMEs even high decrease of threshold from 150 to 30 million HRK results with decrease of only 2.793 companies or 2,46%. Increase of the balance sheet total threshold for SMEs to 500 million HRK shows an increase of 609 companies or 0,55%, which makes SMEs almost completely insensitive to change of balance sheet total threshold. Large companies represent 0,75% of total number of companies related to criteria of the balance sheet total. Number of companies increases for 111 companies with threshold decrease to 130 million HRK, and reduces for 208 companies in case of threshold increase to 200 million HRK.

Table 9: Sensitivity analysis of distribution of companies in classes related to balance sheet total

Micro-entities		SMEs		Large companies	
Balance sheet total (in million HRK)	Number of companies	Balance sheet total (in million HRK)	Number of companies	Balance sheet total (in million HRK)	Number of companies
< 1	74.088	< 30	108.559	> 100	1.207
< 2	85.753	< 40	109.307	> 130	951
< 2,6	89.721	< 100	110.935	> 150	840
< 5	97.694	< 150	111.302	> 200	632
< 10	103.587	< 500	111.911	> 500	231

Source: Authors' calculation using data gather from Financial agency (date: October 28, 2015)

By taking into account comprehensive conclusions on thresholds changes, it can be concluded that SMEs in general have the lowest sensitivity to changes in the number of companies related to all three criteria. As opposed to, to that, as expected, new class of micro-entities shows the highest sensitivity due to the fact that majority of companies concentrate within lesser values of total revenues, balance sheet total, and most companies employ less than five employees. According to new classification system, share of large companies in Croatia is decreased from 0,34% to 0,29%, which still makes higher proportion of companies compared to the European Union average of 0,20% (Decman, et al., 2013, p. 21).

6. Conclusion

Small and medium-sized companies have proportion of more than 99% of total number of companies in most member states of the European Union. They represents the nucleus of business and economy environment of every country. In the European Union, companies' sizes are defined taking into account net turnover, balance sheet total and number of employees. Croatian accounting legislation system is in the process of adjustment by adapting the European classification system which includes micro-entities, small, medium-sized and large companies. Related to that, from the beginning of 2016 there will be a certain regulation changes in that context reflecting the number of companies in particular size class. Results of conducted analysis show that companies in Croatia in 2014 are the

most sensible to the change of criteria thresholds for micro-entities, while there is almost no sensitivity in case of total SMEs sector. In addition to that, it can be concluded that the number of employees and net turnover represents crucial criteria for classification of companies, while balance sheet total have slightly lower influence. By adopting new classification system in Croatia, total number and proportion of large companies decreased, and the number of medium-sized companies increased by widening the range thresholds. Nevertheless, as expected, the greatest proportion of companies in Croatia will be micro-entities. Due to that fact, future efforts of legislators should be directed to the additional simplification of administrative, financial reporting and disclosure requirements regarding micro-entities.

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