

THE READINESS OF MICRO-ENTREPRENEURS FOR CHANGES IN ACCOUNTANCY, IN THE EXAMPLE OF ESTONIA

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Abstract

In the last five years, accounting entities in Estonia have had to adopt a number of changes resulting from various EU directives, and soon they will have to start taking into account the changes arising from the vision of the real-time economy. Quite a few accounting entities have not yet adopted even the current requirements (for example, machine-processed invoices), and many accounting entities do not comply with the reporting obligation properly (fail to submit the annual report or fail to submit the report on time). The article reflects on the future directions of the accounting field and the fulfillment of the accounting obligations of Estonian micro-entrepreneurs, and the readiness for changes resulting from the vision of the real-time economy. A micro-entrepreneur in Estonia is a private limited company whose annual turnover does not exceed 50,000 euros, and the balance sheet volume does not exceed 175,000 euros; in addition, its liabilities may not exceed the equity capital, and such a limited company must be founded by one natural person who is also a member of the board of this private limited company. Micro-entrepreneurs have a simplified reporting obligation to the state: their annual report only consists of a balance sheet and a profit and loss account. Starting in 2018, micro-entrepreneurs are allowed to submit their annual report in a simplified form. The conducted research revealed that it is mainly private limited companies, including micro-entrepreneurs, who fail to submit annual reports. Among the micro-entrepreneurs who have not submitted annual reports, the majority have been operating for less than five years and are not registered as VAT payers. Half of the micro-entrepreneurs do not consider proper monthly accounting to be important, and only half are ready for the changes resulting from the vision of the real-time economy, and the submission of a simplified annual report has not led to a cognitive reduction of the administrative burden.

Keywords: accountancy, accounting, annual report, micro-enterprise, real-time economy, digitization

JEL Classification Codes: F63; G38; M41

1. Introduction

The accountancy policy is constantly changing; in 2016, the EI directive 2013/34/EU was enforced in Estonia, which established requirements for submitting reports and categorized companies based on their economic indicators for the financial year. Once

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again, the field of accountancy is changing. In the future, more and more will be expected from accountancy and reporting, and accounting entities must adopt future guidelines and start implementing them.

National transposition of updated and renewable legislation in the area of financial reporting may have different effects on financial practice. However, there are differences in the EU economic environment, and therefore the transposition of all directives cannot be expected to have the same effect across countries. In Directive 2013/34 EU, there were several inconsistencies, such as the correct and fair reflection between the principle of legally binding and the primacy of content. In 2019, Directive 2014/55/EU of the European Parliament and of the Council on e-invoicing in public procurement entered into force.

Some entrepreneurs in Estonia have not yet managed to understand or adopt the previous changes in accountancy, which came into force in 2016 and 2019 when there were already again new directions in the accountancy policy. Previous changes have largely addressed the change in reporting obligations, the introduction of e-invoicing in dealings with public sector bodies and the transparency of reporting, and the change in the administrative burden on accounting entities. The reports resulting from the changes to the directives had to be submitted by accounting entities for the first time in 2018 for the 2017 financial year.

According to Directive 2013/34/EU, the reports submitted in this way were supposed to lead to a reduction in the administrative burden on companies because requirements for submission of a simplified annual report were established for some companies (including micro-enterprises). The problem is that many Estonian entrepreneurs (including micro-entrepreneurs) do not feel a reduction in their administrative burden; rather, they feel an increase in the administrative burden due to both the additional software changes and the obligation to submit reports to various state institutions. Therefore, it is necessary to find out the readiness of micro-entrepreneurs for changes in accountancy.

In Estonia, as a result of the Accounting Act (2021), a micro-entrepreneur is a private liability company with only one shareholder who must also be a member of the management board; in addition, the total assets of the private liability company as of the balance sheet date may not exceed 175,000 euros and the sales revenue of the accounting year may not exceed 50,000 euros, and the liabilities of the private limited company may not exceed the equity capital.

The purpose of the article is to find out the readiness of Estonian micro-entrepreneurs for the changes arising from the future directions of accountancy. To achieve the goal, the following research tasks are set:

1. To explain the changes related to financial reporting and accountancy policy and the requirements of financial source documents and their cohesion with the vision of a real-time economy and the existing exchange of data between public sector institutions.

2. To analyze the proportion of micro-entrepreneurs in Estonia who have not submitted their 2020 financial year report and their readiness for changes resulting from the vision of the real-time economy and the future directions of the accounting area.
3. From the results of the study, to draw conclusions about the readiness of micro-entrepreneurs for changes in accountancy.

The article is divided into three parts. The first part provides an overview of the nature of financial reporting by accounting entities, explains the situation in Estonia resulting from the implementation of Directive 2013/34/EU (accounting directive), and explains the requirements laid down for the original documents of economic transactions necessary to perform financial reporting resulting from the implementation of Directive 2014/55/EU (e-invoicing). The second part of the article explains the research methodology used, and the third part presents the analysis results and the conclusions drawn from them.

2. Financial reporting in the winds of change

One of the goals of the accounting policy of the European Union is to reduce the differences arising from the national characteristics of the countries in order to harmonize the reporting of accountancy, i.e., so that financial reporting can be understood everywhere in the European Union and the results of the reports are unambiguous and transparent. That is why the reporting directives in accountancy are constantly changing in the European Union.

Harmonization of financial accounting and reporting has been a priority for the European Union since 1960, when the goal was to harmonize company law (Gornik-Tomaszewski 2005). It is known that the accounting principles for companies were first regulated in 1978 by the Reporting Directive 78/660/EEC on the annual accounts of certain types of companies (Fourth... 1978). Over the years, in addition to modernizing company law, modernizing the legal framework for accounting has become a priority in the European Union. Several authors have come to the understanding that the harmonization of company law is a process through which the European Union wishes to reduce differences in reporting between countries (Andreea-Ioana & Pali-Pista 2013; Güldenkoh & Silberg 2014). The directives set out EU-wide principles for the preparation of certain financial statements and have had the general objective of reducing the administrative burden on accounting entities.

According to various studies, it can be argued that the increase in administrative burdens leads to a slowdown in entrepreneurship and may lead to an increase in the informal economy (Neag & Maşca 2012; Столяров и Грошев 2012; Ушаков 2005; Güldenkoh & Silberg 2014). The increase in reporting requirements and accountability will lead to an increase in the administrative burden on accounting entities. To prevent this, a general framework has been established in the European Union, which all Member States' reporting agents must follow. In 2013, previous directives were repealed, and Directive 2013/34/EU of the European Parliament and of the Council on the annual reports of certain types of companies, consolidated financial statements, and related statements

was adopted (Directive 2013/34/EU ... 2013). Directive 2013/34/EU is distinguished from previous directives in particular by three aspects:

- a shift in the focus of the Directive from larger to smaller accounting entities;
- increasing the comparability of information provided through financial statements in the European Union;
- alleviating problems related to the administrative burden.

With regard to some provisions of Directive 2013/34/EU, Member States retained the right to base their national legislation on the wishes and national specificities of national accounting entities. For example, in implementing the EU Directive 2013/34/EU, Estonia was able to introduce special requirements for the categorization of companies that best characterize Estonian accounting entities. Directive 2013/34/EU entered into force in Estonia on 1 January 2016 (Accounting Act 2021). Since 01.01.2016, entrepreneurs in Estonia have been categorized on the basis of the financial indicators of the financial year (assets, sales revenue, average number of employees). Entrepreneurs are divided into four categories: micro-enterprises, small enterprises, medium-sized enterprises, and large enterprises (Accounting Act 2021).

When the Directive entered into force in 2016, it was expected that the change would lead to a reduction in the administrative burden for accounting entities, as the reporting obligation for the components of the annual report was introduced according to the category of the enterprise. For example, simplified requirements were established for micro-enterprises when submitting an annual report (Accounting Act 2021).

Alver & Alver (2013, 13) believes that the requirements of the Directive were aimed at reducing the administrative burden on small enterprises and increasing the comparability of reporting. However, Rämmel (2014) referred to the problem of eliminating the need to prepare a cash flow statement because the cash flow statement gives a true and fair view of the enterprise compared to the balance sheet and income statement, as it is more difficult to manipulate economic indicators due to the lack of accounting estimates, as the cash flows are covered in the reported. Malm (2014) was of the opinion that the reduction of the reporting volume, as much as 97–99%, poses a threat to the transparency and economic stability of the economic environment due to the insufficient availability of financial information.

Savitševa (2019) conducted research among 5,001 legal entities by collecting data on the timely submission of analyzed annual reports to the register in order to find out the relationship between the submission of data on the beneficial owners and the fulfillment of the obligation to submit the annual report, including the fulfillment of the duty of care. The conducted analysis revealed that only 33.11% of those analyzed had submitted their annual report on time in 2018, and 24.25% had not submitted their annual report (Savitševa 2019, 31). Savitševa (2019) checked the failure to submit the analyzed annual reports across previous years, and her analysis revealed that the proportion of those analyzed who had failed to submit the report on time for one year was the highest.

At the request of the Ministry of Finance, the TalTech research group conducted a large-scale study in 2020 to find out the possible reasons for failing to submit annual reports from 2010-2018. To this end, a survey was conducted in September 2020 among legal entities that did not submit the annual report in 2017 or were late in submitting it. The survey was sent to a randomly selected 8287 legal entities, of which 894 responded, and a semi-structured interview was conducted with five late submitters and five non-submitting entities. (Laidsoo *et al.* 2020, 15) The analysis by Laidsoo *et al.* (2020) revealed that the rate of failure to submit reports for micro-enterprises is at the level of 12%.

The results of the analysis commissioned by the Ministry of Finance revealed that (Laidsoo *et al.* 2020, 68):

- As a company ages, it becomes less likely that the company will fail to submit the report.
- The probability of a non-VAT company not submitting an annual report is 85% lower than that of a company liable to VAT.
- A company that has failed fulfilled its tax liabilities is 8.5 times more likely to not submit its annual report than a company that meets its obligations on time.
- As the number of members of a company's management board increases, the likelihood that the company will fail to report will decrease.

Based on the previous research, the authors set the following hypothesis: Among the private limited companies that did not submit the annual reports for the year 2020, the majority of non-VAT taxpayers are micro-entrepreneurs. The obligation to register as a taxable person arises when the sales turnover has reached 40,000 euros since the beginning of the calendar year (§ 19 (1) of the Value-Added Tax Act), and one of the conditions for the micro-enterprise category is a turnover of up to 50,000 euros (Accounting Act 2021).

In Estonia, micro-enterprises and small enterprises can submit to the registrar abridged annual accounts, which consist of a balance sheet, a profit and loss statement, and the necessary annexes (Accounting Act 2021). However, abridged annual accounts must also be drawn up on the basis of the accounting, and if the accounting is not carried out properly, annual reports cannot be drawn up on the basis of those accounts. Allikvee (2006, 11) is convinced that properly carried out accounting is the cornerstone of success, and a true and fair view of a company's financial performance provides an opportunity to analyze mistakes, see the company's strengths, find new solutions and avoid making wrong decisions. Lõhmus (2018, 7) is convinced that accounting and successful business operations only work if the company sees and understands how important it is for the functioning of the integrated economic system that the data is presented fairly; otherwise, the data displayed to the state is incorrect, and competition between companies becomes dishonest.

Accounting is a well-thought-out system that influences different beliefs in economic life, no matter how different they are, and places them in a common logical system

(Mukhametzyanov *et al.* 2017, 1227). All economic transactions related to business activities must be properly documented, i.e., placed in a proper system, and all transactions must have source documents. The source documents must be machine-processable. Only if the person liable for accounting does not have the possibility of handling the machine-processable original document, and the creation of this possibility requires disproportionately large expenses or efforts, the original document may be in another form that enables permanently written reproduction. (Accounting Act 2021) From 01.07.2019, when transferring goods or providing services, a machine-processable invoice (e-invoice) must be submitted to a person liable for state accounting, a local government unit, or a public entity, which must comply with the European standard for e-invoicing (Accounting Act 2021). The fact that e-invoicing became mandatory upon submission to the state accounting entity led to an increase in the administrative burden for micro-enterprises, as they had to start purchasing the machine-processed invoicing service.

The introduction of machine-processed original documents brings with it a digital system, and such rapid data exchange can be considered real-time intercommunication. At the same time, such real-time communication requires the necessary software and daily digital review and validation of data. Krimmer *et al.* (2019) formulated the real economy as a digital ecosystem through which paper-based economic transactions and other transactions are replaced by automatic data exchange in digital, structured, machine-processable, and standardized form.

At the time of writing this article, according to the advisor of the Department of Business and Accounting Policy of the Ministry of Finance, the Ministry of Finance is conducting research, the purpose of which is to analyze the use of e-invoices by companies and the public sector, to identify obstacles to the wider adoption of e-invoices, and to develop improvement proposals for even more widespread adoption of e-invoices. Based on the results of the research, the goal of the Ministry of Finance is the widespread use of e-invoices in transactions between companies by 2023 and the desire to assess whether the obligation stipulated in the Accounting Act to send only e-invoices to the public sector has fulfilled its purpose and whether the system functions as it should. (Suurekivi 2021)

The financial year is normally equal to the calendar year (Accounting Act 2021), and the annual accounts must be submitted to the registrar within six months after the end of the financial year (Commercial Code 2021), i.e., normally by 30 June. According to the e-commercial register statistics of the Center of Registers and Information Systems (2021), as of 23.11.2021, 38.04% of private limited companies have not submitted their annual reports for the year 2020. Despite the simplification of reporting obligations (i.e., reduction of the number of reports), this has not led to compliance with reporting obligations among companies, i.e., among private companies, there is still a large majority of those who have not submitted an annual report by the time of writing this article. As of 23.11.2021, 75,902 of the private limited companies had not submitted annual reports (Center of ... 2021, see table).

The authors are convinced that automation simplifies financial accounting and also the work of accountants who deal with financial accounting on a daily basis. However, it is

definitely necessary to explain to the companies why it is necessary to transmit data digitally, what is done with the data, to whom it is transmitted, and how it is processed and secured. The realization of the vision of the real-time economy must take into account the ability of businesses to make the transition to automation.

3. Methodology

As of 01.12.2021, 69.49% of the companies registered in Estonia have been registered as private limited companies. Almost 1/3 of them have been established without making a share capital contribution. (Center of ... 2021) The founders of such private limited companies are natural persons who have established the private company without financial or non-financial contributions (Commercial Code 2021). When starting a business in this way, for the time being, one is definitely a micro-entrepreneur. Depending on the business activity, the assets of the company also increase, and when preparing and submitting the turnover and annual report, it is clear for the state under which category of enterprise the private company's economic activity is categorized. In Estonia, micro-enterprises can submit to the registrar abridged annual accounts, which consist of a balance sheet, a profit and loss statement, and the necessary annexes (Accounting Act 2021). Based on the submitted annual reports, the number of micro-enterprises can be determined.

The larger the category an entrepreneur belongs to, the more one can be convinced that the accounting obligation is fulfilled properly. At the same time, it is unclear how micro-entrepreneurs fulfill their accounting obligations and what their readiness is for changes in accountancy. The goal of the research is to find out the readiness of Estonian micro-entrepreneurs for changes in the future of accountancy.

A quantitative research methodology is used to fulfill the goal. A probabilistic sampling survey is carried out, the purpose of which is to find out the attitudes and opinions of micro-entrepreneurs. A systematic sample has been selected from the general population, which is micro-entrepreneurs who have not submitted their annual report on time or have omitted to submit it, and a questionnaire has been sent to them. The research is based on statistical data obtained from the Center of Registers and Information Systems and data collected with a questionnaire. The questionnaire (see Annex) is prepared with multiple-choice answers so that they can be compared, processed, and analyzed.

On 20.11.2021, a request was made to find out how many private limited companies by county failed to submit an annual report in 2020 and how many of them are micro-entrepreneurs according to the 2019 annual report or if there is no data (i.e., the annual report for the year 2019 has also not been submitted), then those private limited companies, whose shareholder and board member are one and the same person. Information was also requested on how many micro-entrepreneurs registered for VAT have failed to submit their 2020 annual report (see Table 1).

Table 1. The number of private limited companies, including micro-entrepreneurs, who failed to submit the annual report for the year 2020 by county as of 23.11.2021 (Center of ... 2021, compiled by the authors)

County	Private limited companies that have not submitted a report	Including micro-entrepreneurs	including VAT payers
Harju	45,259	11,018	3,465
Hiiu	344	86	22
Ida-Viru	2,441	497	94
Jõgeva	812	190	42
Järva	915	212	69
Lääne	689	142	48
Lääne-Viru	1,863	418	118
Põlva	737	168	59
Pärnu	3,407	807	217
Rapla	1,194	270	76
Saare	1,495	290	100
Tartu	7,276	1,710	435
Valga	854	206	68
Viljandi	1,541	398	115
Võru	1,137	252	61
not specified	5,938	361	57
Total	75,902	17,025	5,046

The authors of this article wanted to know how many private companies and, out of them, micro-enterprises were among those who did not submit the 2020 annual report and to conduct a survey among micro-enterprises. In addition, the Center of Registers and Information Systems was asked for the e-mail addresses of one thousand micro-entrepreneurs (using a random sample and including all counties) that did not submit a report for the financial year 2020. The inquiry provided 5.87% of the e-mail addresses of the micro-enterprise that failed to submit the annual report and to those who were sent a questionnaire (see Annex) on 25.11.2021.

The purpose of the survey was to find out:

- why micro-enterprises have not submitted annual reports;
- whether micro-enterprises are ready to switch to e-invoicing;
- whether the submission of a significantly simplified annual report from 2018 onwards has led to a cognitive reduction in the administrative burden for micro-enterprises.

The questionnaire was sent to 1000 micro-enterprises, whose addresses were obtained from the commercial register by inquiry through the ankeet.ee portal. The questionnaire

was sent three times (25.11.2021, 05.12.2021, and 10.12.2021). The questionnaire consisted of ten questions (see Annex). Three hundred seventy of the thousand recipients of the questionnaires opened the questionnaire in the survey environment, but only 120 of them answered it. The obtained statistical data and questionnaire answers were organized, explained, and interpreted. 12% of the sample responded to the questionnaire, and the authors consider this result reliable.

4. Result and conclusion

As of 23.11.2021, 38.04% of the private limited companies entered in the register had not submitted the annual report for the year 2020 (Center of ... 2021). The analysis of the data received from the Center of Registers and Information Systems revealed that as of 23.11.2021, 75,902 private limited companies have failed to submit the annual report for the financial year 2020. 22.43% of them are micro-entrepreneurs, and 29.64% of them are registered VAT payers. The largest number of non-reporting micro-enterprises in the financial year 2020 is in Viljandi County (25.83%) and Hiiumaa County (25%); there are the least micro-enterprises among enterprises with an unspecified county (6.08%) and Saare County (19.40%). 29.64% of the micro-entrepreneurs who failed to submit an annual report are liable for VAT. (see Table 1)

The analysis results show that compared to the study by Laidsoo et al. (2020), the number of micro-entrepreneurs who did not submit an annual report has increased by 10.43%, and the probability that a micro-entrepreneur liable to pay VAT fail to submit an annual report has decreased by 15%. It follows from the study that the fulfillment of reporting obligations of private limited companies, including micro-entrepreneurs, is in a downward trend.

The survey revealed that 58.33% of micro-enterprises that did not submit an annual report have been operating for less than five years and 41.67% for more than five years (see Annex, question 1). 41.67% of the respondents were registered VAT payers (see Annex, question 2).

The survey confirmed the authors' assumption: 50% of the respondents (see Annex, question 3) record business transactions on a monthly basis and keep monthly accounts using business software or Excel. Those who did not record transactions on a monthly basis use accounting in either Word or an accounting book, or $\frac{3}{4}$ of them do not keep accounts at all. (see Annex, question 4) 41.67% of the respondents keep the accounts themselves; for 8%, accounting is performed by an accountant; for 16%, the service is provided by a service provider; and in the case of 34.33%, no accounting is performed whatsoever. (see Annex, question 5)

33% of the respondents do not prepare the annual report (see Annex, question 6) because they do not consider it important to submit the annual report (see Annex, question 7). Although the respondents had not submitted an annual report, they replied that their company's annual report was prepared by an accountant (25%) or a service provider (42%), of which 25% considered the submission of the annual report to be very

important and 33% important (see Annex, questions 6 and 7). The majority of respondents were liable for VAT (see Annex, question 2).

When asked whether they are ready to switch to the use of e-invoices and e-receipts, 50% answered positively (see Annex, question 8). The respondents who were not ready cited the following as reasons: "no accounting software"; "business would deteriorate"; "do not want to spend too much"; "do not want to take risks" (see Annex, question 9).

However, none of the respondents felt that their administrative burden had decreased since 2018, when a simplified annual report could be submitted (see Annex, question 10).

The analysis results confirmed the research results described in the theoretical part. Micro-entrepreneurs liable to VAT keep proper accounting records and are more aware of the requirements arising from the duty of care of the entrepreneur. Only 29.63% of micro-entrepreneurs who did not submit an annual report for the year 2020 financial year were liable for paying VAT. Also, as the age of the company increases (Savitševa 2019; Laidsoo *et al.* 2020), the probability that the company fails to submit a report decreases. The hypothesis put forward by the authors did not turn out to be true. Only 22.43% of private limited companies that did not submit annual reports for the year 2020 are micro-entrepreneurs.

Only 25% of micro-entrepreneurs use accounting software, and 25% do their accounting in Excel. The authors are of the opinion that, therefore, when implementing the vision of the real-time economy, micro-entrepreneurs who do not have the capacity to switch to data automation must be initially excluded.

In summary, the study revealed the following: The research revealed that it is mainly private limited companies, of which, according to the available information, 22.43% are micro-enterprises that fail to submit annual reports. The majority of non-reporting micro-enterprises have been operating for less than five years and are not registered for VAT purposes, and do not consider it important to submit an annual report. 50% of the respondents do not consider it important to keep proper monthly accounts; they keep the accounts themselves and use an accountant or service provider to prepare an annual report for them. Only 50% of micro-entrepreneurs are ready to use e-invoices and e-receipts, and submitting an abridged annual report has not led to a cognitive reduction of the administrative burden for micro-entrepreneurs.

The goal set in the article was met, and the readiness of micro-entrepreneurs with applicable changes in the accounting area was determined. It turned out that micro-entrepreneurs are ready for change, but they are not capable of incurring additional monthly costs related to a painless switch to the deployment of accounting software or e-invoicing, as this would reduce the profitability of their economic activities.

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Annex: Questionnaire

1. How many years have you been in business?
 - a. 0-1
 - b. 1-5
 - c. 5+
2. Have you registered for VAT?
 - a. Yes
 - b. No
3. Do you record monthly transactions, i.e., do you keep proper accounts?
 - a. Yes
 - b. No
4. Which tool do you use when keeping accounts?
 - a. Software
 - b. Excel

- c. Word
 - d. notebook
 - e. do not keep accounts
5. Who does the accounting for your company?
- a. Myself
 - b. Accountant
 - c. Service provider
 - d. Friend/acquaintance
 - e. Nobody
6. Who prepares the annual report?
- a. Myself
 - b. Accountant
 - c. Service provider
 - d. Nobody
7. How important is it for you to submit the annual report on time?
- a. Very important
 - b. Important
 - c. Not important
8. Are you ready for the transition to e-invoicing and e-receipts?
- a. Yes
 - b. No
9. If not, why not?
- a. Indicate the reason
10. From 2018, you can submit a simplified annual report. Do you feel a reduction in the administrative burden?
- a. Yes
 - b. No