Financial Reporting Integrity in U.S. Small and Medium-Sized Enterprises: Determinants, Consequences, and a Framework for Structural Improvement.

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ABSTRACT

Financial reporting integrity, defined as the consistent production of financial statements that are complete, accurate, and free from material misstatement or intentional distortion, is a foundational requirement for functional capital markets and efficient credit allocation. In the context of U.S. small and medium-sized enterprises (SMEs), reporting integrity is systematically undermined by a confluence of structural factors: concentrated ownership that compresses demand for external accountability, limited internal control environments that permit undetected error, constrained access to qualified accounting professionals, and a regulatory architecture that leaves governance gaps unaddressed. Drawing on recent empirical literature on private firm reporting quality, voluntary audit adoption, and SME credit access, this paper advances agency theory and information asymmetry theory by demonstrating how their joint operation shapes reporting integrity outcomes in owner-managed firms lacking public capital market discipline. The paper analyzes the determinants and consequences of financial reporting integrity deficits in U.S. SMEs and proposes the SME Reporting Integrity Framework (SRIF), a four-pillar model addressing governance structure, internal control design, external assurance, and professional capacity. The framework is illustrated through a representative case study and supported by coordinated policy recommendations for the Financial Accounting Standards Board, the American Institute of Certified Public Accountants, and the U.S. Small Business Administration. The paper concludes with implications for U.S. economic competitiveness and capital market efficiency.

Keywords: financial reporting integrity; SME; earnings quality; internal controls; voluntary audit.

JEL Classification: M41; M48; G32; G38; L26.

INTRODUCTION

The integrity of financial information produced by business enterprises is not merely a technical accounting concern, it is an economic infrastructure problem with consequences that extend from the individual firm to the national economy. When financial statements reliably represent a firm's economic position and performance, lenders price credit risk accurately, equity investors allocate capital efficiently, suppliers extend trade credit with confidence, and managers make resource allocation decisions grounded in credible internal data. When financial reporting integrity is compromised, whether through intentional manipulation, systemic error, or structural neglect, each of these functions degrades. Capital is misallocated, risk is mispriced, and the informational foundations of market efficiency erode.

For large U.S. public companies, the regulatory architecture governing financial reporting integrity is extensive. The Sarbanes-Oxley Act of 2002 imposed mandatory internal control assessments, CEO and CFO certifications of financial statements, and enhanced auditor independence requirements. The Public Company Accounting Oversight Board (PCAOB) conducts regular inspections of audit firms serving public issuers. The Securities and Exchange Commission maintains an active enforcement division dedicated to financial reporting fraud. Together, these mechanisms create a dense institutional environment in which departures from reporting integrity carry significant legal, reputational, and financial consequences.

No comparable institutional environment exists for the roughly 34.8 million small and medium-sized enterprises operating in the United States. The U.S. Small Business Administration (SBA, 2024) reports that SMEs, defined as firms with fewer than 500 employees, account for 45.9 percent of private-sector employment and approximately 43.5 percent of U.S. gross domestic product. Despite this economic centrality, SMEs are not subject to Sarbanes-Oxley requirements, PCAOB oversight, or mandatory SEC financial reporting. Most are not required to obtain external audits of any kind. Their internal control environments are typically informal, frequently undocumented, and often concentrated in the owner-manager to a degree that makes independent oversight practically impossible. The accounting profession has developed alternative frameworks, including the AICPA's Financial Reporting Framework for Small- and Medium-Sized Entities (FRF for SMEs), but adoption remains voluntary and uneven.

The consequences of this gap are measurable. The Federal Reserve's 2024 Report on Employer Firms, drawing on the 2023 Small Business Credit Survey, identifies access to financing as one of the most significant operational challenges for U.S. small businesses, with more than nine in ten firms experiencing financial or operational headwinds during the survey period. Lenders' credit-assessment processes rely heavily on financial statement quality as a signal of borrower creditworthiness; firms unable to produce credible, verifiable financial information face systematically higher borrowing costs, shorter loan maturities, and stricter collateral requirements (Federal Reserve Banks, 2024). Recent empirical work confirms that accrual-based financial statements, the foundation of integrity-oriented reporting, are positively associated with SMEs' access to lines of credit, larger borrowing amounts, and more favorable loan terms relative to firms using cash-basis accounting (Hong, Kim, Patro, & Yu, 2025).

This paper addresses three interrelated questions. First, what are the principal structural determinants of financial reporting integrity or its absence in U.S. SMEs? Second, what are the measurable consequences of reporting integrity deficits for SME financing, growth, and long-term viability? Third, what practical interventions, organized within a coherent framework, can address these deficits at scale without imposing compliance burdens disproportionate to SME resources? The paper proceeds as follows: Section 2 reviews the theoretical framework and empirical literature, including a detailed description of the literature search methodology; Section 3 analyzes determinants of SME reporting quality; Section 4 examines consequences of integrity failures; Section 5 describes the methodology; Section 6 presents the SRIF; Section 7 provides a case illustration; Sections 8 and 9 offer policy recommendations and limitations; and Section 10 concludes with implications for U.S. national interest.

LITERATURE REVIEW AND THEORETICAL FRAMEWORK

Literature Search Methodology

The literature informing this paper was identified through a structured search of five major academic databases: EBSCOhost Business Source Complete, ProQuest ABI/INFORM Global, JSTOR, ScienceDirect, and Google Scholar. Searches were conducted between January and March 2025 using the following primary search strings: ("financial reporting integrity" OR "earnings quality" OR "earnings management") AND ("SME" OR "small business" OR "private firm"); ("voluntary audit" OR "external assurance") AND ("SME" OR "private firm" OR "small business"); and ("information asymmetry" OR "agency theory") AND ("SME" OR "private firm" OR "owner-managed"). Boolean operators (AND, OR) and truncation symbols were applied consistently across databases.

The temporal scope of the search was restricted to studies published between 2020 and 2026 to capture the most recent developments in the empirical literature on private firm reporting quality. Earlier foundational works including the COSO (2013) Internal Control Integrated Framework and seminal agency theory contributions were retained where they remain the authoritative basis for conceptual claims. Inclusion criteria required that studies be: (a) published in peer-reviewed journals indexed in the Social Sciences Citation Index (SSCI) or Emerging Sources Citation Index (ESCI); (b) directly concerned with financial reporting quality, earnings management, audit adoption, or credit access in private firms or SMEs; and (c) based on identifiable empirical methods (natural experiments, difference-in-differences designs, propensity score matching, or large-sample archival analysis) or comprehensive systematic reviews.

The initial database searches returned 214 potentially relevant records after deduplication. Following title and abstract screening against the inclusion criteria, 61 full-text articles were assessed for eligibility. Of these, 10 studies were ultimately included in the synthesis, prioritizing works with the strongest methodological rigour, the greatest direct relevance to the U.S. SME context, and the most recent publication dates. Additionally, primary source materials from regulatory and policy bodies including the FASB, AICPA, SBA Office of Advocacy, Federal Reserve Banks, OECD, and ACFE were incorporated to ground the institutional analysis in current data. This selection process is summarized in Figure 2 (PRISMA-style flow), with excluded studies omitted because they examined exclusively public firms without private firm comparisons, employed methodologies that did not permit causal inference, or addressed regulatory environments not generalizable to the United States.

Figure 2: Literature Selection Process (PRISMA-Adapted Flow)

Stage	Records / Outcome
Database identification (5 databases, 2020–2026)	214 records after deduplication
Title and abstract screening	61 full-text articles assessed
Exclusion: public-firm-only samples, non-causal methods, non-generalizable settings	51 excluded
Empirical peer-reviewed articles included in synthesis	10 studies retained
Regulatory/policy primary sources added	6 institutional reports (ACFE, Fed, OECD, SBA, FASB, AICPA)
Total evidence base	16 sources forming the review corpus

Source: Author's construction, 2025.

Theoretical Framework: Agency Theory and Information Asymmetry in the SME Context

The academic literature on financial reporting integrity in private and small firms has developed substantially in recent years, driven by expanded access to private firm financial data and growing policy interest in SME credit access. This paper makes a theoretical contribution by demonstrating that agency theory and information asymmetry theory are not merely parallel frameworks for understanding private firm reporting quality they operate jointly and interact in ways that are specific to the SME organizational context, producing compounding effects not fully captured when each theory is applied in isolation.

Agency theory holds that financial reporting serves a contractual monitoring function: it provides principals with information about agents' stewardship of firm resources, enabling performance evaluation and reducing the moral hazard inherent in delegated management (Jensen & Meckling, 1976, as applied to the private firm setting by Beuselinck et al., 2023). The corollary prediction extensively confirmed in the recent empirical literature is that firms with concentrated owner-management structures exhibit systematically lower demand for external financial reporting accountability, because the principal-agent separation that motivates such demand is absent or attenuated (Beuselinck et al., 2023). For U.S. SMEs, where approximately 27.3 percent of employer firms are family-owned and most are owner-managed, this structural feature dominates the reporting environment (SBA, 2024).

The SME context extends agency theory in two important ways that the existing literature has not fully articulated. First, the absence of principal-agent separation in owner-managed SMEs does not eliminate agency problems it displaces them from the owner-manager relationship to the firm-creditor relationship. When the same individual who manages the business also controls its financial reporting, agency costs are transferred to external debt providers, who cannot rely on the firm's reporting process to discipline managerial behavior. This displacement of agency costs from the equity to the debt contract is a theoretically distinct mechanism with direct implications for SME credit pricing, which this paper documents through the empirical evidence of Hong et al. (2025) and Kinyua et al. (2025). Second, the multi-stakeholder incentive conflict in SMEs where tax minimization and credit maximization motivations simultaneously pull reported income in opposite directions creates a unique form of reporting opportunism that is structurally different from the earnings smoothing and income management documented in public firm agency research (Yang et al., 2022).

Information asymmetry theory predicts that when creditors and investors cannot reliably assess the quality of financial information presented by an SME, they respond rationally by pricing residual uncertainty into the terms they offer: higher interest rates, shorter loan maturities, stricter collateral requirements, or outright credit rationing (Akerlof, 1970, applied to the debt contracting context). The Federal Reserve Banks (2024) document that approximately 50 percent of small employer firms that applied for financing during the 2023 survey cycle did not receive the full amount requested, with credit qualification deficiencies of which reporting quality is a central component cited as the primary reason for partial or full denial. This paper advances information asymmetry theory in the SME context by identifying the specific mechanisms through which voluntary assurance adoption reduces the information gap between owner-managed firms and external capital providers a mechanism that operates differently in the SME context than in the public firm setting because external audit serves not only as a credibility signal but also as a partial substitute for the governance monitoring functions absent in owner-managed structures.

The interaction between agency theory and information asymmetry theory is particularly pronounced in the SME setting because both problems are simultaneously maximized: agency costs are highest where governance is most concentrated, and information asymmetry is highest where independent verification is absent. The SRIF, proposed in Section 6, addresses this interaction directly Pillars I and II target the agency problem through governance and control interventions, while Pillars III and IV target the information asymmetry problem through assurance and capacity interventions. This integrated theoretical architecture distinguishes the SRIF from single-mechanism approaches and reflects the joint theoretical contribution of this paper.

Beuselinck, Elfers, Gassen, and Pierk (2023) provide the most comprehensive recent synthesis of the private firm reporting literature, surveying more than three decades of research across European institutional settings. Their review identifies three persistent findings of direct relevance to the U.S. context: private firms exhibit systematically higher rates of earnings management than their publicly listed counterparts; the absence of public capital market discipline is the primary structural driver of this difference; and voluntary audit adoption is associated with measurably higher reporting quality and lower cost of debt financing across multiple institutional settings.

Yang, Hemmings, Jaafar, and Jackson (2022) provide the most recent systematic evidence on the public-private earnings management gap, analyzing a comprehensive dataset spanning 11 European Union countries. They find that private firms engage in systematically more real earnings management than publicly listed counterparts, with the larger gap in jurisdictions with weaker investor protection and higher book-tax conformity. Their partial substitution finding that firms reducing accruals-based earnings management increase real earnings management has direct implications for the SRIF's holistic governance design, as it demonstrates that accounting-standards-based interventions without corresponding governance reforms may displace rather than eliminate the underlying problem.

Recent empirical work has substantially advanced the evidence base on the capital market consequences of SME reporting quality. Hong et al. (2025) examine a large sample of U.S. small businesses and find that firms using accrual accounting have materially better access to external financing than firms using cash-basis accounting maintaining more and larger credit lines, more extensive banking relationships, and the ability to borrow from more distant financial institutions, which the authors interpret as a proxy for reduced information asymmetry between borrower and lender. Kinyua, Changwony, and Campbell (2025) provide complementary international evidence using 102,031 firm-year observations across 151 countries, finding that external audit certification significantly reduces SMEs' probability of facing financing obstacles, with effects concentrated among firms with foreign ownership, larger size, and greater age. Karaibrahimoglu, Lobo, Porumb, and Wang (2022) examine voluntary audit review adoption and find that firms opting out of audit reviews face higher cost of debt financing, increased earnings management, and reduced analyst following.

The OECD (2023) Financing SMEs and Entrepreneurs scoreboard reinforces the policy stakes, documenting persistent financing gaps across OECD member countries and identifying reporting quality deficiencies as structural contributors to credit rationing. It also notes that compliance costs represent a disproportionate burden for smaller firms potentially ten to twenty times the proportion of revenues spent by large enterprises justifying the proportionate, tiered design of the SRIF.

DETERMINANTS OF FINANCIAL REPORTING INTEGRITY IN U.S. SMES

Ownership Structure and Governance Concentration

The dominant organizational characteristic of U.S. SMEs owner-managed structure with concentrated equity ownership simultaneously removes the principal-agent separation that motivates demand for external reporting accountability and concentrates financial control in a single individual whose interests may diverge from those of creditors, minority shareholders, or tax authorities. The SBA (2024) reports that family-owned firms constitute approximately 27.3 percent of U.S. employer firms, while most non-family SMEs are similarly characterized by owner-management without meaningful board oversight. In this governance environment, informal norms rather than formal accountability structures govern the financial reporting process. The absence of audit committees, independent directors, and formal authorization hierarchies creates structural opportunity for departures from reporting integrity that may go undetected for extended periods.

The literature consistently confirms that governance concentration correlates with lower reporting quality. Beuselinck et al. (2023) synthesize three decades of evidence demonstrating that private firm earnings quality is significantly lower than public firm earnings quality across multiple institutional settings, and that ownership concentration is among the most robust predictors of this difference.

Internal Control Environment

Effective internal controls are widely recognized as the first line of defense for financial reporting integrity. The Committee of Sponsoring Organizations of the Treadway Commission (COSO, 2013) Internal Control Integrated Framework provides the authoritative conceptual basis for internal control design and evaluation in the United States. However, SME implementation of COSO-based internal controls is sporadic, often limited to the most basic transactional controls, and rarely subject to formal documentation or periodic evaluation.

The Association of Certified Fraud Examiners (ACFE, 2024) reports that more than half of occupational fraud cases in its 2024 Report to the Nations were facilitated by a lack of internal controls or management override of existing controls. The ACFE further documents that smaller organizations defined as those with fewer than 100 employees experienced median fraud losses of $141,000 per incident, despite having the fewest anti-fraud controls in place. The fundamental constraint facing SMEs in internal control implementation is segregation of duties: in an enterprise with five or fewer accounting staff, meaningful segregation across all financial processes is frequently not achievable.

Professional Accounting Capacity

The quality of accounting judgment embedded in financial statements depends critically on the professional competence of those who prepare them. The median U.S. SME relies on a part-time bookkeeper or small regional accounting firm for financial statement preparation, without the technical depth to navigate complex accounting standards, identify reporting risks, or apply professional judgment in ambiguous situations. Beuselinck et al. (2023) identify preparer competence as a distinct driver of private firm reporting quality separate from governance and oversight structures, noting that the concentration of accounting expertise in small firms often in a single individual with limited continuing education creates a persistent quality floor below which even well-intentioned reporting efforts cannot rise.

Incentive Structure and Reporting Motivation

SME owner-managers face a distinctive and often conflicting set of reporting incentives. For tax purposes, minimizing reported income is typically advantageous, creating incentives to accelerate expense recognition, defer revenue, and exploit allowable accounting options conservatively. For credit purposes, the opposite incentive applies lenders evaluate debt capacity and repayment ability based on reported earnings and cash flow, creating pressure toward income maximization when credit applications are pending. Yang et al. (2022) identify this tension between tax and contractual reporting motivations as a fundamental structural driver of accounting choice in private firms, noting that high book-tax conformity environments suppress accruals-based earnings management but may increase real economic distortions as managers alter underlying business decisions to achieve reporting objectives.

CONSEQUENCES OF FINANCIAL REPORTING INTEGRITY DEFICITS

Cost and Access to Debt Financing

The most extensively documented consequence of SME reporting integrity deficits is impaired access to debt financing on favorable terms. Hong et al. (2025) provide direct U.S. evidence demonstrating that small businesses using accrual-basis accounting have significantly broader access to external financing including more credit relationships, larger credit lines, and more favorable terms than firms using cash-basis accounting. The accrual accounting premium is concentrated among firms with more complex financial structures and multiple banking relationships, consistent with the prediction that credible financial information is most valuable where information asymmetry between borrower and lender is greatest.

Kinyua et al. (2025) extend this evidence to the auditing context, demonstrating that external audit certification significantly reduces SMEs' financing obstacles, with the largest effects for firms with foreign ownership and more complex external stakeholder relationships. The Federal Reserve Banks (2024) corroborate these findings: the 2023 Small Business Credit Survey shows that approximately 50 percent of small employer firms did not receive the full financing amount requested, with credit qualification deficiencies of which reporting quality is a central component cited as the primary cause.

Earnings Management and Long-Run Performance

Beyond its consequences for external financing, weak financial reporting integrity creates conditions conducive to earnings management the exercise of managerial discretion over reporting choices to achieve predetermined outcomes rather than faithful representation of economic reality. Yang et al. (2022) document that private firms engage in systematically higher levels of real earnings management than public firms, and that the gap is largest in jurisdictions with the weakest governance environments. Their partial substitution finding has particular relevance for U.S. policy design: accounting-standard-based interventions that reduce discretionary accruals without addressing underlying governance and control deficits may displace rather than eliminate earnings management activity.

Beuselinck et al. (2023) synthesize the longer-run consequences of private firm earnings management, noting that firms with persistently lower reporting quality tend to have higher effective borrowing costs, reduced ability to attract equity capital, and greater vulnerability to covenant violations during economic downturns consequences that can be existential for resource-constrained SMEs.

Fraud Risk and Business Failure

The ACFE (2024) Report to the Nations, covering 1,921 cases of occupational fraud across 138 countries, finds that small businesses experienced a median loss of $141,000 per fraud incident, with asset misappropriation substantially enabled by the absence of segregated duties and independent financial review. More than 50 percent of occupational frauds were directly attributable to weak internal controls or management override conditions endemic to the SME reporting environment. The median fraud scheme lasted 12 months before detection, a duration during which undetected losses compound and reporting integrity is further eroded by concealment adjustments.

METHODOLOGY

This study employs a qualitative analytical research design comprising three complementary approaches. The first is the systematic literature review described in Section 2.1, conducted through structured database searches prioritizing studies published between 2020 and 2026 that address U.S.-context or internationally generalizable findings. The review prioritizes empirical studies with identifiable causal mechanisms natural experiments, difference-in-differences designs, and propensity score matched samples over purely descriptive analyses.

The second component is a comparative institutional analysis examining the regulatory and professional frameworks governing SME financial reporting in the United States, including the FASB Private Company Council's simplifications to U.S. GAAP for private companies, the AICPA's FRF for SMEs, SSARS compilation and review standards, and SBA reporting requirements for lenders administering guaranteed loan programs. This analysis draws on primary source materials from the FASB, AICPA, SBA Office of Advocacy, and Federal Reserve Small Business Credit Survey.

The third component is a deductive framework development methodology. The SRIF is constructed from the theoretical and empirical findings of the literature review and evaluated against a representative case illustration designed to assess its practical applicability and internal consistency. Qualitative design is appropriate for the policy-oriented research question, which requires the integration of institutional knowledge, theoretical reasoning, and empirical evidence that purely quantitative approaches cannot readily synthesize. The study acknowledges that large-sample statistical validation of the SRIF's projected outcomes lies beyond its scope and identifies this as a priority for future empirical research, as discussed in Section 9.

THE SME REPORTING INTEGRITY FRAMEWORK (SRIF)

Framework Overview

The SME Reporting Integrity Framework organizes practical integrity interventions around four mutually reinforcing pillars: governance structure, internal control design, external assurance, and professional capacity. The framework is designed for scalable application across the SME size spectrum, with the intensity of each pillar's requirements calibrated to firm size, complexity, and external reporting obligations. The SRIF explicitly rejects the application of public-company reporting standards to SMEs without modification an approach that generates compliance costs disproportionate to the integrity benefits achieved in favor of a risk-proportionate model that directs oversight resources toward the specific vulnerabilities most consequential for each firm's stakeholder relationships.

Figure 1 presents a schematic diagram of the SRIF, illustrating the four pillars, their principal components, the theoretical frameworks underpinning each, and the expected outcomes of integrated adoption. As the diagram illustrates, Pillars I and II address the agency problem through governance and control mechanisms, while Pillars III and IV address information asymmetry through assurance credibility and preparer knowledge. The four pillars operate interdependently: governance improvements create demand for rigorous internal controls; strong controls make external assurance more meaningful and cost-effective; credible assurance increases lenders' willingness to

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rely on financial statements; and professional capacity ensures that all three preceding pillars are implemented competently.

Figure 1: The SME Reporting Integrity Framework (SRIF)

SME REPORTING INTEGRITY FRAMEWORK (SRIF)			
Goal: Credible, proportionate financial reporting for U.S. SMEs			
PILLAR I	**PILLAR II**	**PILLAR III**	**PILLAR IV**
Governance Structure	**Risk-Proportionate Internal Controls**	**External Assurance Calibrated to Need**	**Professional Capacity & Education**
• Financial Oversight Committee • Independent review >$1M debt • Annual statement review • Authorization hierarchies	• Tier 1: Foundational controls (all firms) • Tier 2: Enhanced controls (>$1M rev.) • Tier 3: Advanced controls (>$5M rev.) • Tech-enabled compensating controls	• FRF for SMEs (owner-financed firms) • SSARS compilation/review (bank debt) • Full GAAS audit (SBA/PE/bond finance) • Tiered cost-proportionate structure	• Mandatory CPE for SME practitioners • CPA mentorship (solo to regional) • SBA-funded owner-manager training • Financial literacy / credit access link
Theoretical Anchors: Agency Theory (governance + control pillars) ↔ Information Asymmetry Theory (assurance + capacity pillars)			
Expected Outcomes: Lower cost of debt • Expanded credit access • Reduced fraud losses • Enhanced long-run firm viability			

Source: Author's construction, 2025.

Pillar I – Governance Structure

The governance pillar addresses the owner-management concentration that is the primary structural predictor of reporting integrity risk in SMEs. The SRIF recommends that firms with external institutional debt financing above a materiality threshold proposed at $1 million in outstanding bank or non-bank institutional credit establish a Financial Oversight Committee comprising at least one financially literate independent member: an outside accountant, a retired banker, or an experienced independent director. This committee reviews annual financial statements before transmission to lenders, approves significant accounting judgments, and authorizes unusual or non-recurring transactions. The committee's function is not equivalent to an audit committee under Sarbanes-Oxley it requires no formal audit engagement but it introduces an element of independent review that substantially reduces the undetected error and manipulation risk associated with pure owner-management reporting, directly addressing the agency problem identified in Section 2.2.

Pillar II – Risk-Proportionate Internal Controls

The internal controls pillar operationalizes COSO (2013) principles within SME resource constraints through a risk-ranked implementation hierarchy. The SRIF categorizes internal control requirements into three tiers: foundational controls applicable to all firms (including bank reconciliation discipline, expense authorization protocols, and segregated custody of checks and access credentials); enhanced controls for firms with revenues exceeding $1 million (including monthly management account reviews, formal accounts receivable aging, and documented inventory protocols); and advanced controls for firms with revenues exceeding $5 million or significant external financing (including formalized closing procedures, variance analysis, and periodic internal control self-assessment). Technology-enabled compensating controls accounting software access logs, automated transaction flags, and cloud-based duplicate payment detection are identified as cost-effective supplements for SMEs unable to achieve full segregation of duties. The ACFE (2024) finds that organizations with surprise audits, management reviews, and employee training experience significantly lower fraud losses, consistent with this tiered design.

Pillar III – External Assurance Calibrated to Need

The external assurance pillar establishes a tiered assurance continuum aligned with firms' external financing relationships. For firms relying primarily on owner and family financing with no institutional debt, the FRF for SMEs provides a fit-for-purpose reporting basis without mandatory assurance. For firms with institutional bank credit facilities, annual SSARS compilation or review engagements provide a cost-effective credibility signal that reduces the information asymmetry identified in Section 2.2. For firms with SBA-guaranteed loans, private equity involvement, or institutional bond financing, annual audits under generally accepted auditing standards are recommended. This tiered design responds directly to Hong et al. (2025), who document that the external financing benefits of higher-quality accounting are largest among firms with more complex financing relationships, and to Karaibrahimoglu et al. (2022), who find that even relatively low-cost voluntary assurance mechanisms generate measurable reductions in cost of debt financing. The OECD (2023) estimates that compliance cost reductions of 30 to 50 percent relative to full audit conversion are achievable through tiered assurance approaches.

Pillar IV – Professional Capacity and Education

No governance structure or control framework can compensate for fundamental gaps in accounting knowledge among the individuals responsible for preparing and reviewing SME financial statements. The professional capacity pillar addresses this through three interventions: mandatory continuing professional education requirements for practitioners who prepare SME financial statements under AICPA standards, with a specific focus on private firm reporting risks identified by Beuselinck et al. (2023); structured mentorship programs connecting small and solo-practitioner CPA firms with larger regional firms that can provide technical consultation on complex accounting issues; and SBA-funded financial literacy training for SME owner-managers focused specifically on the relationship between financial reporting quality and credit access. This latter intervention responds to the Federal Reserve Banks' (2024) finding that small businesses most often do not apply for financing because they believe they will be denied a self-rationing behavior that financial literacy investment could address.

CASE ILLUSTRATION: CLEARHAVEN MAINTENANCE LLC

Clearhaven Maintenance LLC is presented as a representative U.S.-based service-sector SME generating approximately $4.2 million in annual revenue through the provision of commercial maintenance contracts to property management companies. The firm employs 38 staff, carries $850,000 in revolving bank credit and $1.1 million in term debt, and has historically prepared annual financial statements under U.S. GAAP using the services of a sole-practitioner CPA under a compilation engagement. This case illustrates SRIF implementation across all four pillars for a firm at the enhanced control tier (revenues between $1 million and $5 million) with institutional debt financing.

Before adopting the SRIF, Clearhaven exhibited reporting integrity vulnerabilities characteristic of its size and structure. The owner-manager authorized all payments and controlled check preparation without independent review a segregation of duties failure enabling asset misappropriation (ACFE, 2024). Revenue recognition timing for multi-month service contracts was applied inconsistently across contract types. Accounts receivable aging was not formally maintained, resulting in material understatement of doubtful account provisions. No independent oversight existed for the owner-manager's expense reimbursement claims. The firm's lending bank had twice requested upgraded financial statement assurance as a credit renewal condition, a request deferred due to perceived cost.

Following SRIF adoption, Clearhaven implemented Pillar I governance through appointment of a retired commercial banker as an independent financial oversight advisor, meeting quarterly to review management accounts and annually to review year-end financial statements before lender submission. Pillar II enhanced controls were implemented through accounting software configuration changes separating payment authorization and check release functions and introducing automated alerts for transactions outside normal parameters. Pillar III assurance was upgraded from compilation to SSARS review engagement reflecting Clearhaven's institutional debt financing relationship at a total incremental cost of approximately $8,500 annually. Revenue recognition policies were standardized in writing across all contract types, and a formal accounts receivable aging process was incorporated into the monthly close.

The outcomes of SRIF implementation were measurable and prompt. At the next annual credit facility renewal, the lender reduced Clearhaven's revolving credit interest rate by 45 basis points and extended the credit line from $850,000 to $1.2 million without requiring additional collateral an outcome the lender's credit officer attributed explicitly to improved financial statement credibility and governance structure, consistent with Hong et al. (2025) and Kinyua et al. (2025). The restated accounts receivable provisions identified a previously unrecognized doubtful account concentration in one client segment, enabling corrective action that avoided an estimated $62,000 in credit losses. This case illustrates the SRIF's capacity to generate immediate, quantifiable financial benefits while establishing the reporting infrastructure necessary for long-term firm credibility and growth.

POLICY RECOMMENDATIONS

SBA Loan Program Reporting Standards

The U.S. Small Business Administration should strengthen financial reporting requirements for SBA 7(a) and 504 loan program participants, establishing tiered assurance requirements calibrated to loan size: SSARS review for loans between $250,000 and $1 million, and full GAAS audit for loans exceeding $1 million. The SBA guaranteed approximately $36 billion in 7(a) and 504 loans in fiscal year 2023 (Federal Reserve Banks, 2024). Leveraging this market presence to drive reporting quality improvements across a significant portion of the SME population would generate measurable improvements in program integrity as well as borrower financing outcomes, consistent with Kinyua et al.'s (2025) finding that external audit certification reduces financing obstacles most effectively for SMEs within formal institutional lending relationships. Compliance cost burdens should be mitigated through SBA technical assistance grant programs to subsidize assurance engagement costs for qualifying small businesses.

FASB Private Company Council Mandate Expansion

The FASB's Private Company Council (PCC) has successfully simplified several U.S. GAAP standards for private company application. The PCC's mandate should be expanded to address reporting frameworks for micro-enterprises and sole proprietorships a population currently underserved by both full U.S. GAAP and the AICPA's FRF for SMEs. A simplified, principles-based reporting standard for entities below a defined revenue threshold analogous to the IASB's IFRS for SMEs standard, whose adoption has been associated with improved reporting quality and lower cost of debt financing in recent international evidence (OECD, 2023) would provide a recognized authoritative basis for financial statements that lenders, tax authorities, and investors could rely upon with greater confidence.

AICPA Practitioner Support Programs

The AICPA should develop and mandate structured continuing professional education programs specifically addressing SME financial reporting risks, including modules on identifying earnings management red flags, applying COSO internal control principles in resource-constrained environments, and communicating reporting quality findings to owner-manager clients. The AICPA's peer review program should incorporate SME-specific criteria addressing revenue recognition consistency, related-party transaction transparency, and owner-manager expense reporting controls. Beuselinck et al. (2023) identify preparer competence as a distinct driver of private firm reporting quality; continuing education investment directly addresses this structural gap.

Federal Reserve Small Business Credit Survey Enhancement

The Federal Reserve's annual Small Business Credit Survey should incorporate standardized questions measuring financial reporting practices including audit or review engagement adoption, accounting basis (accrual versus cash), and internal control formalization alongside existing credit outcome measures. This would enable longitudinal tracking of reporting practice trends and provide the empirical foundation for evaluating the capital market impact of reporting quality improvements. Hong et al. (2025) demonstrate that accrual accounting status is measurably associated with better credit access even among small businesses; incorporating this variable into the annual survey would allow policymakers to monitor how broadly accrual adoption is diffusing across the SME population and whether SRIF-type interventions are improving reporting quality at scale.

LIMITATIONS AND FUTURE RESEARCH AGENDA

This study has several limitations that qualify the generalizability of its findings and recommendations. The inherently private nature of SME financial data constrains the availability of large-sample empirical evidence on U.S.-specific SME reporting quality determinants. The international evidence drawn upon particularly Beuselinck et al.'s (2023) European synthesis and Kinyua et al.'s (2025) multi-country analysis is informative but not directly transferable to the U.S. institutional context, which differs in legal tradition, creditor rights, tax system design, and professional accounting standards.

The SRIF's four-pillar design is normative rather than empirically validated in the U.S. context. While each pillar is grounded in recent theory and supported by empirical evidence, the integrated framework has not been tested through controlled field studies or quasi-experimental designs. The Clearhaven case illustration is a constructed example rather than a live field observation. Future research should evaluate SRIF adoption outcomes through longitudinal field studies or difference-in-differences designs comparing reporting quality and financing outcomes for SRIF adopters versus matched non-adopters, of the type employed by Kinyua et al. (2025) in the international context. Such empirical validation is identified as the most important agenda for future research arising from this paper particularly, whether the interaction effects between the four pillars produce the compounding benefits hypothesized by the joint agency-information asymmetry framework developed in Section 2.2.

The paper does not address SME financial reporting in technology-intensive sectors where revenue recognition complexity under ASC 606 creates challenges that extend beyond those analyzed here. Future research should examine whether the SRIF's governance and control pillars are sufficient for high-complexity SME sectors or whether sector-specific extensions are required. Finally, the rapid diffusion of artificial intelligence-powered accounting software represents both an opportunity through automated reconciliation and anomaly detection and a risk through reduced human oversight of AI-generated accounting entries whose net effect on SME reporting integrity warrants dedicated empirical attention.

IMPLICATIONS FOR U.S. NATIONAL INTEREST AND CONCLUSION

The argument of this paper carries direct implications for U.S. economic competitiveness and national prosperity. The SBA (2024) reports that 34.8 million small businesses account for 45.9 percent of private-sector employment, approximately 43.5 percent of GDP, and 39 percent of all private-sector payroll. Their ability to grow, invest, and create employment depends critically on access to capital and access to capital depends, in ways this paper has documented comprehensively, on the quality and credibility of their financial reporting.

This paper has made three contributions. Theoretically, it advances agency theory and information asymmetry theory by demonstrating their joint operation in the SME context showing that agency costs displaced from the equity to the debt contract, combined with information asymmetry between owner-managers and creditors, produce compounding reporting integrity deficits not fully captured by either theory applied in isolation. Empirically, it synthesizes the most recent U.S. and international evidence on the capital market consequences of SME reporting quality, demonstrating that the financing premium associated with credible reporting is substantial and measurable. Institutionally, it proposes the SRIF as a practical, proportionate architecture for addressing these deficits within the genuine resource constraints of U.S. SMEs.

The SRIF does not ask small businesses to become large ones. It proposes a graduated, risk-calibrated approach that aligns the intensity of reporting oversight with the materiality of external stakeholder relationships, producing meaningful integrity improvements at costs that the recent empirical literature demonstrates are more than recovered through improved financing terms, reduced fraud exposure, and expanded credit access. In a period of sustained attention to U.S. economic competitiveness, workforce development, and small business resilience, investing in the financial reporting infrastructure of the SME sector is an underappreciated but high-return policy priority. Future empirical research validating the framework's projected outcomes will both strengthen its policy case and advance the broader scientific understanding of financial reporting integrity in the understudied but economically central private firm sector.

Ethical Considerations

Ethical Approval: This study is a qualitative analytical and systematic review of publicly available empirical literature. It does not involve the collection of primary data from human subjects or animals, and accordingly, no institutional ethical approval was required or sought.

Conflict of Interest: The author declares no conflict of interest. No funding body had any role in the design of the study, in the collection, analysis, or interpretation of the literature reviewed, in the writing of the manuscript, or in the decision to submit the paper for publication.

Data Availability Statement

This study does not generate or analyze original datasets. All empirical findings referenced in this paper are drawn from previously published studies and publicly available institutional reports, including materials from the Association of Certified Fraud Examiners (ACFE), the Federal Reserve Banks, the OECD, and the U.S. Small Business Administration. These sources are fully cited in the References section and are accessible via the URLs and DOIs provided therein. No additional data were created or used beyond those available in the cited publications.

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