

ON SOME ISSUES REGARDING NON-PUBLICATION OF RESEARCH AND DEVELOPMENT DISCLOSURES IN THE FINANCIAL STATEMENTS OF BULGARIAN INNOVATIVE ENTERPRISES

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Abstract: The paper presents the results of a survey carried out by the author among practising accountants in Bulgaria regarding the publication of research and development (R&D) disclosures in the financial statements of innovative enterprises. The aim is to study some of the potential reasons for the current accounting practice of underestimating the mandatory and voluntary disclosure of R&D data. The adopted research methods are based on logical, deductive and comparative methods. The study results encourage literature development by presenting a more in-depth analysis of the factors influencing R&D data disclosure by Bulgarian enterprises.

Keywords: R&D, disclosure, references, financial statements.

JEL: M400, M480, M410.

Introduction

Currently, Bulgaria is in the group of 'modest' innovators (European Innovation Scoreboard, 2018) due to many factors including the low amount of invested funds in research and development (R&D) (Georgieva, T., 2013, p. 27). The budget of Bulgarian enterprises intended for creating and

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implementing innovative solutions is formed mainly by own funds and receipts from abroad. The level of confidence creditors have in small and medium-sized enterprises in the country is low, thus causing a decrease in funds for research projects. The accounting, financial and non-financial data disclosed in the financial statements of enterprises directly impacts creditors' confidence. On the one hand, the purpose of similar disclosures is to provide certainty that information in the financial statements is reliable, discreet, neutral, impartial, complete in all aspects and, above all, necessary for making sound economic decisions. On the other hand, they are an indicator of a company's profitability in the foreseeable future. However, data from previous studies on publishing textual information of financial and non-financial nature is indicative of a low level of R&D disclosures in the financial statements of Bulgarian innovative enterprises applying national accounting standards. (Georgieva, D., 2020; Georgieva, D., 2019). The results of the analysis also report on a predominant lack of mandatory data for standard disclosure compared to voluntary data. Non-publication of R&D data as part of the disclosures of innovative enterprises is affected by a number of internal and external factors (Georgieva, D., 2019), which, however, do not fully explain the aforementioned negative trend. An explanation for non-disclosures can be found both in the attitude of those who prepare the reports to the publication of textual information on R&D and in their understanding of the nature and importance of research and development.

The main research problem of the study is the attitudes of individuals responsible for preparing and submitting financial statements to disclosing data of a mandatory and voluntary nature and to the accounting recognition and reporting on research and development. The research area of the study is a survey carried out by the author among practising accountants in Bulgaria. The aim is to deduce certain causal relationships and dependencies regarding the lack of data or publishing scarce information of mandatory and voluntary nature in the appendices to the financial statements of enterprises in our country. The main research task is to give accountants' opinion on research and development accounting reports and compare them with a previous author study of factors influencing the disclosure and content of published mandatory and voluntary R&D data (Georgieva, D., 2019; Georgieva, D., 2020). The main hypothesis of the author is that publishing

R&D data as an appendix to the financial statements of Bulgarian innovative enterprises is mainly influenced by the subjective attitude of accounting and management staff towards the added value similar disclosures have. As a result, disclosures concerning innovative development in micro and macroeconomic aspect are underestimated mainly due to misunderstanding of the R&D nature by accounting staff.

The adopted research methods are based on logical, deductive and comparative methods, as well as on the methods of analysis and synthesis.

1. Literature review

Studies on the factors affecting R&D textual information disclosure in the financial statements of 143 innovative enterprises (Georgieva, D., 2019) are indicative of the fact that the type and structure of capital, as well as the presence of audit control have the main impact (Ponce, H. et al., 2016, p.14; Wallace, R. et al., 1994; Teixeira da Silva, S. et al., 2013, p. 400; Barako, D. et al., 2006; Georgieva, D., 2018, p.109). The strongest statistical correlation is between the presence of audit control and the descriptive R&D data published in the financial statements of the analyzed organizations (Cramer's V: 0.338, $p < 0.05$). In this case, however, the reported average statistical relationship does not explain the standing out negative practice of incomplete publication of mandatory and voluntary information in the statements (Georgieva, D., 2020). Although the analysis substantiates the existence of a causal relationship between the size of organizations and the publication of R&D information, similar final conclusion cannot be considered fully relevant due to unfulfilled conditions for applying the chosen research method. The study accounts for a weak statistical relationship between the applied accounting basis and disclosures (Cramer's V: 0.268, $p < 0.05$). However, the accounting standards chosen for the preparation of the reports have a causal relationship to the impossibility of correct comparability of R&D economic and financial information in the statements of enterprises. This could be explained by the lack of harmonization between international and national standards, resulting in incorrect methods of presenting R&D data in the financial statements (Pozharevska, R. & Sn. Basheva, 2019, p. 40) and

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is an obstacle to their clarity and international comparability (Alves & Antunes, 2010; Nobes & Parker, 2008). In this context, an average statistical relationship between the accounting basis chosen by enterprises and the presence of foreign participation in the capital of organizations is accounted for (Cramer's V: 0.206, $p < 0.05$).

It is noteworthy that the comparative analysis of the mandatory and voluntary disclosure of R&D data gives predominance to the voluntary one (Georgieva, D., 2020). In this regard, the majority of organizations that publish information on the methodology and approaches in recognizing and reporting research activities and assets resulting from the development phase disclose additional information. However, a small number fully publish the disclosures required by AS 38 and IAS 38. This contradicts the idea of the same level of mandatory data disclosure by enterprises applying national or international accounting standards. The existence of similar negative trends raises the question of why Bulgarian innovative enterprises refrain from publishing disclosures in their statements. The answer can be sought both in the attitude of the people preparing the statements to the disclosure of R&D data and in their understanding of the nature and significance of similar activities.

2. Study of accountants' attitude towards recognizing, reporting and disclosing research and development activities

A survey was conducted by the author in order to determine accountants' understanding and attitude to recognizing and reporting on R&D as part of the activities of enterprises. On the basis of a tested pilot questionnaire, a final one was prepared by using nominal and ordinal measurement scales, as well as opportunities for an open-ended answer to be given by respondents. In order to ensure the reliability of the study, surveys were conducted online, individually and anonymously with a requirement to submit an up-to-date e-mail address when starting filling in the questionnaire. Social networks and specialized online forums for accountants, e-mails to contact accounting organizations randomly selected

from the Internet were used for the purposes of disseminating the questionnaire. The survey was conducted in the May-August 2019 period. Nearly 22% of the 228 questionnaires sent were filled in and processed by the author. The results of the processing were obtained on the basis of the methods of mathematical statistics.

From a socio-demographic and professional point of view, 56% of the respondents are female, 76% have a university degree (master's degree), 78% have over 10 years of professional experience in the field of accounting, and 48% are chief accountants. Based on the enterprises the respondents represent, micro-enterprises to which respondents provide accounting services prevail (54%). 88% of them are non-financial, preparing a balance sheet. 24% of the organizations represented by respondents carry out research and development activities. From the data above it can be concluded that for the most part respondents have the necessary life experience and educational qualifications to be able to answer the questions included in the questionnaire properly.

However, the majority of the respondents (68%) state that the organizations they represent do not prepare and submit to the NSI either a report on innovation activities or a report on research and development activities of the enterprise. It is noteworthy that 16% of the respondents state that enterprises they represent prepare and submit a report on research and development only, while 14% a report on innovation only. However, the two reports are related to each other and present the same activity of an enterprise in qualitative and quantitative terms. The discrepancy in the data can be sought on the basis of the answers to the question "Why doesn't the company submit either of the two reports?" 75% of the respondents state that the organization does not carry out research and development activities. 71% believe that it does not create innovative products and services. The reason for not preparing the reports for about 41% of the respondents is the impossibility to correctly determine whether the activity performed by the organization falls under the hypotheses of research. 27% of the respondents point out that the enterprises they represent have research projects, but report on costs as current costs in accordance with the requirements of the standards. Based on the answers of the respondents, it was determined that in over 50% of the cases chief accountants are the people preparing the two

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reports. They also prepare the financial statements and develop the accounting policies of enterprises. In this regard, the unclear classification of the activity as research or not by the person who determines the elements of the report may be pointed out as a reason for not submitting correct information to the statistics.

The approach applied to accounting for R&D expenses when creating an intangible asset resulting from the research activities of enterprises has a direct effect on the financial results of organizations (VanderPal, G., 2015, p. 138). In accounting theory and practice, different approaches have been adopted to reporting on R&D expenditures. Without claims for a comprehensive analysis, the following are among them:

- All R&D expenses are capitalized in the cost price of the resource created.
- All expenses are reported as current costs for the period of their occurrence.
- Expenditures are accumulated in a specially opened account, after which they are subject to adjustment.
- Costs are capitalized when certain conditions are reached (selective capitalization).

48% of the respondents share the opinion that reporting on R&D products should be done on the basis of selective capitalization and according to the requirements of the standards applied. In the open-ended question in the questionnaire, as the main reasons they point out the impossibility to prove the economic benefits of the asset during the research phase, and the existing risk that the resource will not proceed to the development phase. The percentage (44%) of the individuals who consider the approach to full capitalization of costs during the reporting period to be the most appropriate is relatively high, regardless of the stage of their occurrence. Respondents mainly justify the answer that the primary goal of an internally created intangible asset as a result of R&D is the development of a resource, which predetermines the expected economic benefits from its use. They also agree that if asset development does not reach the stage of development all capitalized costs can be reported on as a loss for companies under the relevant legislation. In addition, respondents account for the ongoing process of resource creation as a factor encouraging full

capitalization. Thus, it is considered that this will give a real idea of the cost of the asset and the subsequent depreciation costs will be fairly accrued. 50% of the respondents agree that such assets must be more accurately and honestly reported on. 36% of the respondents point out that capitalization of all costs in the cost price of an internally created intangible asset will reduce fluctuations in the revenues and profitability of enterprises. However, it is noteworthy that according to 40% of the respondents, full capitalization would lead to a decrease in investments in R&D and innovation, while 32% of them think that this would encourage similar activities.

The majority of the respondents (54%) agree that Bulgarian companies refrain from disclosing R&D data, while stating (56%) that capitalization of all costs in the cost price of an internally generated intangible asset will result in more detailed disclosure in the financial statements. Voluntary disclosure of R&D data has no impact on achieving a certain efficiency over the activity of enterprises in comparison with a previous reporting period. 42% of the respondents share a similar opinion, while 40% of them think the impact is positive. Respondents (60%) point out that disclosing more R&D data has a positive impact on achieving certain forecast data for the purposes of the investment analysis. However, only 24% state that it has a similar impact on attracting research investment. Although data analysis shows that for the majority of the respondents publication of detailed information on research and development activities of companies has a positive effect on the reliability of financial statements (54%) and organizational prestige (46%), it does not affect the creation of competitive advantage (24%) and achieving the profit desired by the management staff (48%).

A great number of external and internal environmental factors affect the information on R&D disclosed by companies (Nekhili, M. et al., 2016; Archambault, J. & Archambault, M., 2003; Francis, J. et al., 2005; Teixeira da Silva, S. et al., 2007). Without any claims for a comprehensive analysis, the object of study in the survey is the impact of the size of enterprises, the presence of foreign participation in the capital of organizations, the conduct of an independent financial audit of the reports, and the chosen accounting basis. The reason for a similar choice is the author's goal to carry out a comparative analysis with previously studied financial statements of

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innovative enterprises (Georgieva, D., 2020; Georgieva, D., 2019). Additional factors subject of research are liabilities and the accounting profit, as having a significant impact on the level of disclosure (Teixeira da Silva, S. et al., 2013, pp. 399-400). The factors affecting the publication of R&D data in the financial statements of enterprises, according to respondents, are the size of enterprises (38%), the requirement for independent financial audit (38%), the accounting standards selected by organizations (32 %) and the presence of foreign participation in the capital (20%). Factors that do not affect are the amount of liabilities (96%) and the amount of the accounting profit (90%) of enterprises.

In terms of content, respondents believe that disclosed data should contain information about the types of activities defined as research (70%), the types of activities enterprises define as development (58%), the moment when capitalization of costs begins (58%), data on implemented research projects (44%), as well as the types of intangible resources resulting from the activities of organizations (66%). Identifying research and development as an element of disclosure should not be viewed as information harmful to enterprises, but rather as an opportunity to enhance its reputation based on data reliability, completeness and credibility. Determining the costs that could be reported on as research and development directly depends on the type and subject of activities performed by organizations, as well as on the duration of the individual phases of the innovation process. However, it is essential to determine when capitalization of costs should begin. Despite the opinion that organizations should publish data on funds invested in research projects (60%) and development activities (56%), a detailed report on costs by type of activity (fundamental, applied, scientific) is not necessary. The participants in the survey (68%) report that the management staff affects the type of published R&D data in the financial statements of organizations, as for 34% the degree of impact is high.

3. Questions for discussion

The lack of representativeness due to the small number of respondents is accounted for by the author as a major shortcoming of the

study. An additional limitation is the relatively small number of individuals who have filled in the questionnaire, who prepare and submit to the NSI a report on innovation activities and/or a report on research and development activities. For these reasons, statistical relationships and dependencies cannot be reliably analyzed. However, the survey data is a prerequisite for further analysis of the problem based on the following conclusions:

First, the majority of accountants who took part in the survey have a positive attitude towards R&D data disclosure in the financial statements of enterprises. They believe that this will increase the reliability of the statements, the prestige of organizations and will improve the investment analysis. However, this contradicts the reported non-publication of R&D information by Bulgarian innovative enterprises studied by the author (Georgieva, D., 2020; Georgieva, D., 2019). The lack of significant disclosures of development activities compared to the reported opinion of respondents can be explained by the influence of the management staff on the published data pointed out by respondents. These results substantiate the opinion of Cheng, J. & J. Zhao (2018) that the management apparatus affects the disclosed R&D information. However, this does not explain the lack of published appendices to the financial statements of the analyzed enterprises, as well as the low level of mandatory disclosed data.

Second, the majority of respondents point out chief accountants as the people who prepare and submit reports on innovation and R&D to the NSI. At the same time, 41% of the respondents state that the non-submission of both reports by the organizations they represent is due to the impossibility to correctly determine whether research and development is actually carried out. A legal requirement exists that if the research phase cannot be distinguished from the development phase of an internal project for creating an intangible asset, costs should be treated as if they have been incurred in the research phase only (i.e. are continuously reported). This can be considered a prerequisite for incorrect reporting on R&D, which also affects the data published in the field. A similar hypothesis can be substantiated by the fact that in some of the analyzed financial statements, numerical data on research expenditures is disclosed, without the necessary disclosures being published. On this basis, we can raise the question to what extent reports submitted to the statistics are reliable, hence the information submitted to

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national and international databases about the innovation potential and development of Bulgaria.

Third, the percentage of respondents supporting the approach currently applied to accounting for internally created intangible assets is relatively the same as those who support full capitalization. It is assumed that in case of full capitalization of the spent funds, disclosed information is more detailed (Nekhili, M. et al., 2016). This ideology is accepted by more than half of the respondents. If costs are capitalized within the period of occurrence, regardless of the phase during which they are spent, the effect of capitalization will generally be associated with an increase in the value of assets in the balance sheet of an enterprise; high profitability during the reporting period; lower return on capital and assets in the following accounting periods, as well as a decrease in a company's profit in the following accounting periods (based on the reported depreciation costs). Therefore, adopting the approach would not harm the net income and return on equity for the current period. However, it may put pressure on ROA and reduce profitability (Das et al., 2009). The information that is relevant to investors and reflects the profitability of research projects is summarized by capitalizing R&D costs. At the same time, however, it may lead to capitalization of funds for a failed project that does not bring benefits in future accounting periods. According to advocates of the approach, although the research phase is more risky than the development of an innovative project, it is a primary, inevitable and significant stage in the creation of the final product, so organizations should also take into account the resources spent during this period when calculating the cost price of the asset. It is believed that capitalization of R&D costs is chosen by companies with low profitability (Persson, A. & Karen, F., 2011). The selective capitalization (an approach currently used in Bulgaria) reduces the information asymmetry between companies and market participants (Lev, B. & Sougiannis, T., 1996). However, selective capitalization can lead to inaccurate financial forecasts related to difficulties in predicting the economic benefit of research projects, the cost capitalization rate, subsequent amortization and depreciation of the intangible asset (Tami, D. et al., 2015). The advocates of the approach argue that it contributes to higher forecast data accuracy, lower forecast variance, and lower forecast error related to capitalized costs (Mohd, E., 2005). This is

because development costs, which meet the capitalization criteria, also cover those for recognizing a resource as part of an enterprise's assets. In addition, the approach provides important information for investors. In this respect it is positively related to the returns and share prices of organizations (Cazavan-Jeny, A. & Jeanjean, T., 2003). However, selective capitalization is subject to a certain amount of subjectivity in determining whether criteria for capitalization are met. This is mainly due to the diverse nature of research, the subject of activity of enterprises and the type of the final product created. For this reason, when capitalizing costs, greater intervention by management staff and the provision of targeted data in the financial statements of enterprises is possible (Callimacy, A. & Landry, S., 2003, p.134).

Fourth, the majority of respondents specify additional data that should be included in the information to be disclosed in the financial statements of organizations, in the part intended for R&D and internally generated intangible assets. This cannot be perceived as a reason explaining the lack of subject to mandatory disclosure data on R&D in analyzed statements of Bulgarian innovative enterprises (Georgieva, D., 2020). However, the question to what extent respondents attach more importance to mandatory R&D disclosure than to voluntary should be raised. Similarly, in a comparative analysis of the content of the additionally disclosed data in the financial statements of the surveyed enterprises (Georgieva, D., 2020) and the information for publication pointed out by the analyzed individuals, significant differences can be outlined. In particular, the priority information provided by respondents for a detailed classification of the activities as research and development as well as the moment from which the capitalization of costs begins are not subject to disclosure in the analyzed reports. It is appropriate and useful to conduct a more in-depth study of the reasons why accounting staff disclose or do not disclose R&D information they consider relevant.

Conclusion

The analysis of the questionnaires is indicative of the fact that respondents lack in-depth understanding of the nature of research and development and of the 'silent' support for the current practice of not disclosing similar information. This can be explained by the fact that Bulgarian enterprises do not develop high-tech innovations, but prioritize their research activities in the direction of creating incremental product or process innovations. Currently, the state policy is focused on conducting tax audits, ignoring R&D disclosures as a factor that may have a positive impact on the innovation potential of our country. The attitude of the accounting staff, whose focus is oriented to the performance of mainly tax-administrative functions and tasks, is similar. In the context of current global technological developments, non-publication of mandatory information on the research activities of innovative enterprises may doubt the accuracy of the data provided in reports.

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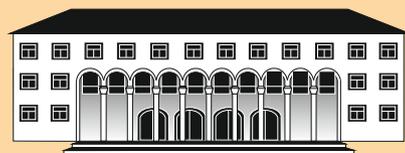
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