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Boychinka Yonkova

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**Second Italian Conference on Social and Environmental Accounting Research
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Environmental issues and external reporting in Bulgaria

Boychinka Yonkova

Faculty of Accounting and Finance - University of National and World Economy
Studentski Grad Hristo Botev, Osmi Dekemvri Str., Sofia 1700, Bulgaria – Phone: + 359 888584614 -
Fax (office): (+ 359 2) 9623903 – www.unwe.acad.bg - Email: bjonkova@abv.bg

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Abstract

Having a relationship between environmental management systems and financial reporting practices could potentially lead to discrepancy in management and reporting objectives. Not only do both disciplines stand to benefit from each other, but they may also shape and inform mutual decision making. To date, environmental financial reporting is highly variable across accounting regimes in Bulgaria, especially on the estimation and reporting methods of environmental expenses and liabilities. The paper discusses the needs for better financial reporting, stronger management practices, and sound corporate governance.

1 - Introduction

Bulgaria is one of the most recent members of the European Union. This is why Bulgaria has the duty of all EU member states to follow and adhere to the program of compliance with duties. For instance, in the field of environmental protection, Bulgaria is among countries that have water accounts (As report in the Global Assessment of Environmental Statistics and Accounts). However, Bulgaria is part of in a group of countries have requested assistance or advice from United Nations Statistics Division (UNSD) on the implementation of System of Environmental - Economic Accounting for Water (SEEAW).

Having a relationship between environmental management systems and financial reporting practices could potentially lead to discrepancy in management and reporting objectives.

Not only do both disciplines stand to benefit from each other, but they may also shape and in-

form mutual decision making.

To date in Bulgaria, environmental financial reporting is highly variable across accounting regimes, especially on the estimation and reporting methods of environmental expenses and liabilities.

This report discusses the needs for better financial reporting, stronger management practices, and sound corporate governance.

This paper includes certain key messages, namely that:

- Regulating the environmental accounting cannot be considered separately. Instead it must be considered in the context in the environment in which the companies are operating, and within the overall process of the development of financial reporting, and
- We would enjoy certain advantages if we improve the mechanism of cooperation between the national authorities-regulatory bodies in the field of accounting, and the protection of the environment.

2 - Forces/factors affecting corporate behavior

As more and more countries open their doors to foreign investment and businesses themselves expand across borders, the public and private sectors are recognizing the benefits of having a commonly understood financial reporting framework of the Social and Environmental Accounting supported by high-quality, globally accepted standards.

There are a number of forces affecting the companies' behavior, such as:

- Shareholders,
- Board of directors,
- Management,
- Legislature,
- Regulatory bodies,
- Auditors.

In the different countries their impact differs in terms of intensity. In Bulgaria shareholders have little power on companies, and it may prove necessary that the legislative organs grant extra powers to the auditors and the regulatory bodies.

The loss of credibility in financial reporting, having many causes, requires a multi-faceted solution -not just by external auditors, but by all those involved in the financial reporting process.

Management and boards of directors, internal and external auditors, standard setters, regulators, and other participants in the financial reporting process, all have important roles to play.

To rebuild and maintain credibility, these groups must focus sharply on the public interest.

3 - Background information of Environmental Accounting in Bulgaria

3.1 – *Applicable accounting standards*

As of date, the enterprises in Republic Bulgaria have been preparing and submitting their annual financial statements on the basis of IAS/ IFRS.

Under the Accounting Act exceptions are made only with regard to:

- Small and medium-sized companies, which, for at least one of the two previous years have not exceeded the indicators of two of the following criteria:
 1. carrying amount of assets as of 31 December - 8 million leva;
 2. net revenues from sales - million leva.;
 3. average staffing levels for the year - 250 employees, and
- The newly established enterprises.

These enterprises face the choice to draft and submit their annual financial statements on the basis of the International Accounting Standards or on the basis of the Bulgarian National Standards for Financial Reporting for small and medium-sized enterprises.

The National Standards for Financial Reporting for small and medium-sized enterprises are adopted by the Council of Ministers and have been brought in line with the EU To wind up, in Bulgaria all entities have made use IAS/IFRS since 2002

- listed companies & consolidated statements
- listed companies & separate statements
- The right to choose for MSEs between IAS/IFRS the National Standards for Financial Reporting for small and medium-sized enterprises also based on IAS/IFRS
- no mandatory chart of accounts
- separate financial accounting and taxation
- framework law + mandatory standard.

3.2 – *History*

In the national accounting practices the issue of reporting assets, liabilities, and costs for environmental protection was originally regulated by National Accounting Standard No. 6 Reporting of costs for environmental protection. With the adoption of the National Standards for Financial Reporting for small and medium-sized enterprises (in effect as of 1 January 2005, promulgated in State Gazette. No.30 of 7 April 2005), which have been brought in line with the IAS/ IFRS, this question has no longer been treated by a separate standard.

This standard referred to the enterprises incurring the following costs for environmental protection:

- a) fixed tangible assets acquired for the purpose of environmental protection;
- b) intangible assets acquired for the purpose of environmental protection;

- c) environmental protection and recovery, including costs for:
- maintaining the balance of the environment;
 - eliminating damage, inflicted on the environment in the process of activity;
 - recovering, preserving and improvement of the environment;
- collecting information and exercising control over the state and preliminary evaluation of the impact on the environment.

Table 1 – Financial information and environmental non-financial parameters

No	Name	Name of the controlling and monitoring parameters	Standards in Bulgaria or EU	Factual value of the parameters as of date	Deviations	Technical solution
1.	Measures to improve the quality of the atmosphere					
2.	Measures for soil					
3.	Measures for waters					
4.	Measures for reducing the negative impact of waste					
5.	Measures for reducing the negative impact of the physical factors on the environment					
6.	Measures for the re-cultivation and the improvement of the biological diversity					

Source: National Accounting Standard No. 6 Reporting of costs for environmental protection

The notes to the annual financial statement required the publication of the following information of the costs environmental protection:

- a) costs for the reporting period – by nature and value; including. Costs for training and advertising;
- b) expected costs for future periods – by nature and value.

This standard answered the following questions:

- Environmental costs: to expense *or* capitalize
- Classification of environmental costs
- Disclosure on details and/or breakdowns about environmental costs

This standard also required publishing the financial information and environmental non-financial parameters. To separate and define the costs for environmental protection for future periods, the enterprise was to provide the following information in a table 1.

This is why this standard laid the foundations of Environmental Accounts as an organized body of information (data system) that links environmental and economic data sets in Bulgaria. This standard may be assessed as Bulgaria's first attempt to show inter-relations between economy and environment and to provide physical as well as financial measures.

3.3 – Present conditions

With the adoption of the National Standards for Financial Reporting for small and medium-sized enterprises (in effect as of 1 January 2005 , promulgated in State Gazette. No..30 of 7 April 2005), which have been brought in line with the IAS/ISFR, the National Accounting Standard for reporting the environmental protection costs was removed. However, several problems related to the assets, the liabilities and the environmental costs are treated in IAS/IFRS and by analogy in National Standards for Financial Reporting for small and medium-sized enterprises. The following standards can be given as an example:

- IAS 16 Property , Plant and Equipment;
- IAS 37 Provisions, Contingent Liabilities and Contingent Assets;
- IAS 38 Intangible Assets;
- IAS 36 Impairment of Assets;
- IFRS 6 Exploration for and Evaluation of Mineral Resources;
- IFRIC 1 Changes in Existing Decommissioning, Restoration and Similar Liabilities;
- IFRIC 5 Rights to Interests arising from Decommissioning, Restoration and Environmental Rehabilitation Funds;
- FRIC 6 Liabilities arising from Participating in a Specific Market-Waste Electrical and Electronic Equipment

Therefore the situation in Bulgaria as of date is as follows:

- Shareholders, creditors, financial analysts, and accountants demand reliable financial information.
- Society demands environmental awareness and corporate accountability for environmental damage.
- Accounting standard setters understand these demands.
- As with standardization efforts for INSTITUTE of CERTIFIED PUBLIC ACCOUNTANTS in BULGARIA, he is also attempts to harmonize financial reporting for environmental issues.

Intergovernmental Working Group of Expert on International Standards of Accounting and Reporting (ISAR), International Accounting Standards Committee (IASC) and the standard setting organizations of most countries have issued general positions or statements of accounting policies and these can be applied to the disclosure of accounting policies relating to environments liabilities and costs.

However, in Bulgaria this aspect of disclosure has not been solved yet, which is due to several problems.

4 - Problems

In Bulgaria annual financial statements are not what they used to be. One of the problems is the lacking awareness as to the fact that disclosure, transparency, and materiality go hand-in-hand with auditing and accounting. Corporate governance reform efforts are focused around translating the concept of corporate responsibility into practice. This means enlarging the scope of conventional financial reporting to include non-financial information such as that relating to environmental and social issues. Traditionally trained accountants and financial analysts generally have a poor understanding of such issues.

Financial reporting and disclosure requirements have to change rapidly. Presenting the assets, the liabilities and the environmental costs in them, and the non-financial information and analysis of the environmental risk would allow not only providing external users of financial statements with accurate data to move business decisions forward, but also delivering figures that do not fall, when the evaluation moves out of the financial modelling framework.

Any accounting policies that specifically relate to environmental liabilities and costs should be disclosed. To enable the user of the information to assess an enterprise's current and future prospects regarding the impact of environmental performance on the financial position of the enterprise. Intergovernmental Working Group of Expert on International Standards of Accounting and Reporting (ISAR), propose that the following is disclosed:

- Nature of costs and liabilities
 - A brief description of any environmental damage;
 - Any laws or regulations forming the basis of remediation;

- Any reasonably expected change to laws, regulation, technology reflected in amount provided.
- Type of issues pertinent to an enterprise and its industry.
 - Formal policy and programmes adopted or their absence noted.
 - Improvements in key areas made since the policy was introduced or the last five years, whichever is shorter.
 - Extent to which environmental protection measures have been in response in government legislation and the extent to which government requirements have been achieved.
 - Any material proceedings under environmental laws.

The critical factors of a successful investment in Bulgaria's environmental sector may be the following:

- Untimely or partial financing;
- Terminating the procedure under the Public Procurement Act;
- Unfair treatment of the suppliers under the concluded contracts;
- accidents;
- Changes in the macroeconomic indicators of the environment;
- The forecasts for the dynamics of demand, which is related to the demographic growth of the population in the city;
- price changes, which are largely dependent on the decisions made by the national or regional authorities;
- The lack of capacity to respond to shocks affecting the investment (which often require additional capacity at the early stages of the activity);
- The decisive importance of the accompanying intervention (for instance, the effectiveness of the water supply is largely dependent on the condition of the water supply networks).

Before the corporate orientation towards management accounting as a distinct and independent function, environmental issues were more likely to be addressed through financial reporting items such as profitability, sales, return on investment (ROI), etc., and these items were likely to be used for environmental and other decision-making. However, as financial accounting and management accounting developed into separate and independent fields of practice, Environmental Accounting began to develop on its own. The development of sophisticated costing and strategic management tools as part of the attempt to break away from 'backward-looking' financial reporting opened up opportunities for Environmental Accounting. The recent demand for better environmental information and management along with more transparent and comparable financial statements suggests an interesting triangulation of consumer or investor demands, management accounting, and financial reporting.

In Bulgaria for the purposes of the management accounting analysis, several problems may be singled out, which have effect in drafting budgets and studying deviations. Key issues that may arise are as follows:

- Reporting depreciation charges. In compliance with the tasks of the European Community (art. 25 of Regulation 1260/1999 (General provisions on the Structural Funds), art. 1 of Regulation 1164/94 (Cohesion Fund), art. 2 of Regulation 1267/1999 (Instrument for Structural Policies for Pre-Accession (ISPA)) in compiling the forecast reports, depreciation charges and not calculated, nor is any profit taken into account, which may distort the financial result. A distorted cash flow may be arrived at, since corporate income tax and depreciation charges are not provided for, which are defined not by applying the functional principle, but under the Corporate Income Tax Law in Bulgaria.
- Whether the payments on the implementation of the projects as costs and the subsequent reimbursement of the amounts as revenues have been reported correctly, taking into consideration the fact that these often occur in two different reporting periods. On the environmental projects, the principles of financial accounting (the principle of comparability of revenues and costs) are to be observed, since they underlie the Bulgarian Accounting Act - art.1 paragraph. 4. – State Gazette, No. 105 of 2006, in effect as of 01.January 2007, namely – the costs incurred in relation to a specific transaction or activity, should be reported under the financial result for the period in which the enterprise has benefited from them, whereas the revenues should be reported for the period, in which the costs for their acquisition have been reported.
- Another essential problem is choosing the time horizon with regard to the determined net current value, and the choice of a discounting factor.

5 - Action plan for the resolving of environmental issues and external reporting in Bulgaria

Some recommendations for Bulgarian financing reporting for external users are:

1. Greater and more uniform disclosure of environmental risk;
2. Separate reporting of environmental expenditures in financial statements;
3. Increased capitalization of preventive measures;
4. Current assessment and accrual of estimated costs at the balance sheet date;
5. Industry standards in high-risk industries for accruing contingency reserves for highly probable environmental losses; and
6. Disclosure that distinguishes between outlays (either past or future) for remediation (for past damage) and those for abatement and prevention (of future damage).

If many of these recommendations are implemented, the benefits to business and society will be substantial. Responsible financial reporting should:

1. Allow investors to make more informed decisions about their economic resources. Understanding the potential for future obligations reduces the risk of future uncertainties.
2. Allow creditors to evaluate more carefully their exposure to loan defaults. Bankers and other creditors must have the necessary information to evaluate a client's ability to satisfy financial commitments.
3. Encourage businesses to invest in the future of the environment and more carefully assess their operating environment.
4. A reduction of economic uncertainty should favorably impact a firm's cost of debt and equity.
5. Continue to generate positive responses from company owners. Research has shown that quality environmental reporting is responded to favorably by company stockholders.
6. Reduce the risk of audit failure by CPA firms. Advanced disclosure and recognition criteria, along with improved audit procedures, should decrease the number of suits filed by holders with vested interests.

6 - Conclusion

The identification and interpretation of environmental problems and risk will continue to challenge the accounting profession. Accounting standard setters are actively evaluating approaches that may improve the reporting of the problems. However, realistically, we can hope that, in the course of time, general principles may be agreed upon and agreements arrived at with regard to cooperation in financial reporting for external users. An international agreement on general principles may facilitate the efficiency of international cooperation, boosting this effective cooperation. We have made much progress in addressing the challenges of globalization and international convergence, but our journey is far from over. We must continue to take the steps that are necessary to demonstrate, in fact and in appearance, that the accounting profession is unwavering in its commitment to quality.

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