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COMPETENCE CENTRES AND PECULIARITIES OF THEIR ACCOUNTING: CASE OF LATVIA

Abstract. On the international arena, a new and specific business formation – Competence Centres (CC) – develops its activities on a broader scale. There, with the aim to create new products and technologies, unite the leading enterprises of the respective industry, scientific institutions and government. The author describes the core and spread of CC on the international scale, studies the functioning, structure and financing of the EU Structural Funds programme «Competence Centres» in Latvia. Since the structure of CC is rather complicated and usually there are several studies performed simultaneously, it is important to analyze the specific requirements set for accounting at these centres. The author analyzes and assesses the specificity of accounting at the CC and in details studies the accounting policy regarding research and development costs on the international scale and the Latvian CC, as well as the peculiarities regarding the recognition of CC income and expenses. As a result of research, there have been identified the deficiencies in the legislation regulating accounting at the CC in Latvia and there have been developed recommendations for their elimination.

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Keywords: Competence centre (CC); Competence centre accounting policy; accounting of the financing granted by the EU Structural Funds.

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ЦЕНТРИ КОМПЕТЕНЦІЙ ТА ОСОБЛИВОСТІ ВЕДЕННЯ БУХГАЛТЕРСЬКОГО ОБЛІКУ: СИТУАЦІЯ В ЛАТВІЇ

Анотація. На міжнародному рівні дедалі більше розвиває свою діяльність відносно нова та специфічна форма бізнесу – центри компетенції (ЦК), або науково-практичні центри. Їх діяльність спрямована на створення нових продуктів і технологій, вони поєднують провідні компанії, науково-дослідні інститути відповідної галузі та уряд. У статті автор характеризує суть і міжнародне поширення ЦК, досліджує програму структурних фондів ЄС «Центри компетенції», її діяльність, структуру та умови фінансування в Латвії. Оскільки структура ЦК є досить складною і в них зазвичай одночасно відбувається ряд досліджень, важливо провести аналіз специфічних вимог ведення бухгалтерського обліку в цих центрах. Автор аналізує та дає оцінку специфіки бухгалтерського обліку в ЦК, докладно досліджує облікову політику витрат на дослідження і розвиток на міжнародному рівні та у ЦК Латвії, а також розкриває особливості визнання доходів і видатків у цих центрах. У результаті дослідження виявлено деякі неточності в законодавстві Латвії, що регламентує облік у ЦК, та розроблено рекомендації щодо їх усунення.

Ключові слова: центр компетенції (ЦК), облікова політика у ЦК, бухгалтерський облік коштів, отриманих від структурних фондів ЄС.

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ЦЕНТРЫ КОМПЕТЕНЦИИ И ОСОБЕННОСТИ ВЕДЕНИЯ БУХГАЛТЕРСКОГО УЧЕТА: СИТУАЦИЯ В ЛАТВИИ

Аннотация. На международном уровне все более развивает свою деятельность относительно новая и специфическая форма бизнеса – центры компетенции (ЦК). Их деятельность направлена на создание новых продуктов и технологий, они объединяют ведущие компании, научно-исследовательские институты соответствующей отрасли и правительство. В статье автор характеризует суть ЦК и их международное распространение, исследует программу структурных фондов ЕС «Центры компетенции», ее деятельность, структуру и условия финансирования в Латвии. Поскольку структура ЦК является достаточно сложной и, как правило, в них одновременно происходит ряд исследований, важно провести анализ специфических требований ведения бухгалтерского учета в этих центрах. Автор анализирует и дает оценку специфике бухгалтерского учета в ЦК, подробно исследует политику учета затрат на исследования и развитие на международном уровне и в ЦК Латвии, а также раскрывает особенности признания доходов и расходов в этих центрах. В результате исследования были выявлены некоторые неточности в законодательстве Латвии, регламентирующем учет в ЦК, и разработаны рекомендации по их устранению.

Ключевые слова: центр компетенции (ЦК), учетная политика в ЦК; бухгалтерский учет средств, полученных от структурных фондов ЕС.

Introduction. In order the enterprises could perform successfully under the conditions of modern global market, they shall ensure the development and distribution of qualitative, competitive end-product or service. This, in its turn, could be achieved by using innovative knowledge and the latest technological processes, the development of which requests considerable investments of human resources and financial resources. It should be pointed out that the innovations and sustainable products with a high added value are often developed only as a result of the activities carried out by individual enterprises or scientific institutions, because not to all market participants there are available the necessary resources. During the last 20-25 years on the international arena a new and specific business formation – competence centres (CC) – develops its activities on a broader scale. There, with the aim to

create new or to improve considerably the existing products and technologies unite the leading enterprises of the respective industry and scientific institutions. The activities of CC are mostly (70-80%) co-financed within the framework of State programmes. In 2011, the EU Structural Funds programme «Competence Centres» commenced its activities in Latvia. This programme is co-financed from the finances of European Regional Development Fund. Since the structure of CC is rather complicated and usually there are several studies performed simultaneously, it is important to analyze the peculiarities of the performance of such centres and specific requirements set for accounting at these centres.

Purpose. Based on the studies of the essence and performance of Competence Centres (CC) to assess the regulation of CC accounting in Latvia. In order to achieve the aim the author

has structured the research in two parts. In the first part of the article there have been characterized the essence and spreading of CC on the international scale, as well as there have been studied the performance, structure and amount of financing of CC in Latvia. In the second part of the article the author has analyzed the requirements set for the accounting at the CC in Latvia; the author has studied in detail the accounting policy for research and development costs and the peculiarities for the recognition of the income and expenses of these centres. At the end of the article there have been presented the conclusions drawn as a result of research performed and the suggestions for the improvement of legislation of Latvia regulating the CC accounting.

The monographic, analysis and synthesis **methods** have been used in the current research.

1. Performance of Competence Centres

Competence Centres (CC) have been developed as a uniform platform in order to facilitate the research oriented towards the long-term development and the development of new products and technologies, thus facilitating the development of innovations and competitiveness of enterprises. There are three partners uniting in such centres: the enterprises of the respective industry, scientific institutions and the government. As it was recognized by Arnold E., Mannik K. and other specialists in their final report, CC have been evolving internationally over the past 20 years or so and they have become an international phenomenon. While they tend to have a basis in the design of the US NSF's Engineering Research Centres programme, their designs have been evolving as they diffuse through different countries and are adapted to the needs of the local innovation systems. They are intended to have an effect on university resource allocation and strategy, in addition to reinforcing university-industry links. To this end, they involve an unusually high degree of subsidy, often 60% or so (Arnold, Mannik et al., 2008, p. 57). Measures of CC success primarily include:

1. direct influence on innovation, generating wealth and jobs;
2. research-trained people, particularly adapted to working in industry;
3. close-to-market practical and empirical knowledge, directly useful in design and development;
4. fundamental understanding useful to the industrial infrastructure over the longer term;
5. extended networks of people and organisations;
6. increased attractiveness of the local innovation infrastructure, influencing the location of R&D and production for firms with interests in the specified sector (The University of Leeds, 2008).

CC are very active in the following countries: USA, Great Britain, Ireland, Germany, Austria, Sweden, Taiwan, Switzerland, Australia, Canada, Hungary, Estonia and Latvia. There are some largest international CC showed in Table 1.

As we can see in Table 1, the first such centres appeared in the USA, when in 1985 the National Science Foundation's Engineering research centres commenced their activities, and they have provided a model for subsequent similar schemes across many world regions.

In Latvia the adoption of international experience regarding the CC took several years, until in 2010 there were adopted the laws and regulations regulating the CC performance, and in 2011 the EU Structural Funds programme «Competence Centres» (activity) started its performance. The implementation of CC performance in Latvia is ensured by the Ministry of Economics of the Republic of Latvia, responsible for this activity, and the Investment and Development Agency of Latvia (IDAL) that performs the functions of a co-operation institution for this activity. IDAL is under the monitoring of the Ministry of Economics of the Republic of Latvia.

In conformity with the provisions of laws and regulations, the Ministry of Economics of the Republic of Latvia ensures the implementation, monitoring and control of the activity, as well as provides information for the community and ensures the publicity for the issues related to the implementation of the activity. But the main functions of IDAL are to take and assess the submissions on the CC projects, to conclude contracts on the implementation of the project with the CC, to accept the amendments to the projects in compliance with the contract and the laws and regulations, to verify and approve the CC requests for payments, as well as to submit the suggestions to the Ministry of Economics of the Republic of Latvia how to improve the implementation of the activity and projects (Regulation No. 361 The Cabinet of Ministers of the Republic of Latvia, 2010, para 8).

It is determined in Latvia that CC is a legal person the shareholders of which are at least one scientific co-operation partner and at least three industry co-operation partners that are not interrelated. Besides, there might be also involved the enterprises and scientific institutions registered in other countries, providing that the proportion of CC shares owned by such participant does not exceed 49%. The organizational structure of the EU Structural Funds programme «Competence Centres» existing Latvia has been presented in Figure 1.

According to the information provided by IDAL, in 2011 six CC started their activities in Latvia, and in 2014 they are active in the following industries: chemistry and pharmacy (Pharma and Chemistry CC of Latvia), information technologies (Information and Communication Technologies CC), forestry (Forestry CC), electronics (Electrical and Optical Equipment Manufacturing Industry CC of Latvia), environment, biotechnologies and bioenergy (Environmental, Bioenergetics and Biotechnologies CC), engineering industry (Transport Machine-Building Industry CC). In these CC there have united the leading enterprises of the industries and the scientific institutions – total: 70 enterprises and 20 scientific institutions, and the total amount of the public financing for this activity from 2011 till 2015 is LVL 37 373 845, or EUR 53 178 191 (IDAL, 2014).

There have been set the possible maximum limits for the public financing of the CC of Latvia, which could be granted to cover the eligible costs of projects. The amount of public financing depends on the status of merchants participating in the CC (a micro, small, medium or large merchant in compliance with the criteria set in the Commission Regulation (EC) No. 800/2008) and on the CC activity performed, which should be supported (see Table 2).

As we can see in Table 2, in Latvia there is partially support the industrial research, experimental research to be performed by the CC and also partially covered the EU project management costs from the EU Fund. It must be pointed out that the partial financing of management costs should be viewed positively, because the CC structure is complicated, there are several participants in it (see Figure 1), and at the same time it is possible to perform several studies, thus the financing ensures the possibility to involve as professional management team for the CC as possible. Thus in Latvia the CC are open, oriented towards the long-term performance organizations, which are

Tab. 1: Some International Competence Centre Programmes

Country	Start date	Agency	Competence centre programme
USA	1985	National Science Foundation	Engineering Research Centres
Ireland	1988	EOLAS/Forfás	Programmes in Advanced Technology
Canada	1989	NSERC, CHIR, SSHRC	Networks of Centres of Excellence
Australia	1990	Ministry of Industry	Co-operative Research Centres
Sweden	1994	NUTEK/SEM/VINNOVA	Competence Centres
Austria	1999	BMVIT/TIG	Kplus
		BMW/FFF	Kind, Knet
Hungary	2002	Ministry of Education	KKK
Estonia	2003	Ministry of Industry	Competence Centres

Source: Arnold, Clar, and Bussillet, 2004, p. 5

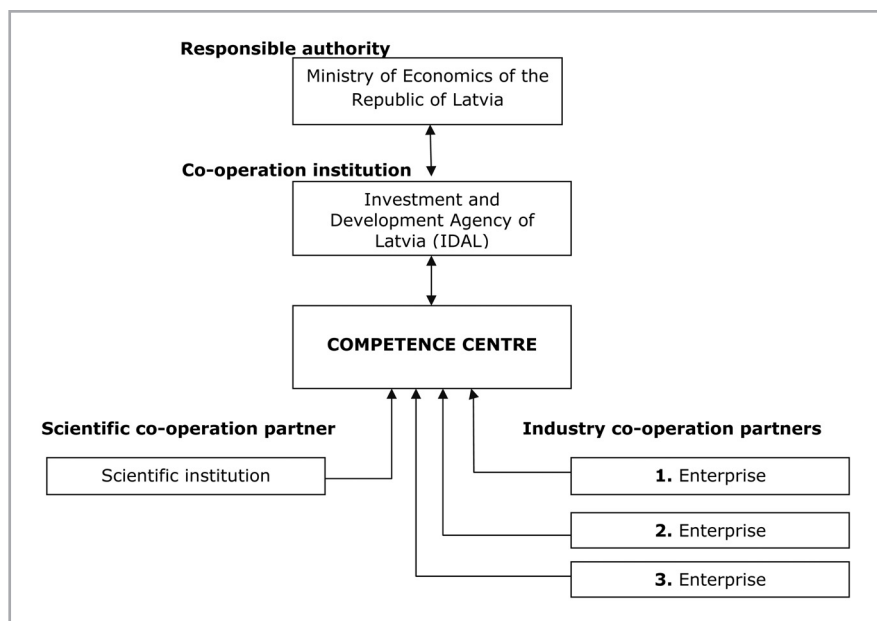


Fig. 1: The Structure of the EU Programme «Competence Centres» in Latvia

Source: Author's design, using the Regulation No.361 adopted by the Cabinet of Ministers of the Republic of Latvia in 2010

these centres regarding the conduct and organization of accounting. The accounting for the competence centres in Latvia is regulated by the following main laws and regulations: Annual Accounts Law, Law On Accounting, Regulation No. 585 «Regulation Regarding the Conduct and Organization of Accounting» adopted by the Cabinet of Ministers, Regulation No. 537 «Procedures for Presenting Financial Support (Financial Aid), Donations and Gifts in Cash or in Kind of the State, Local Governments, Foreign States, the European Community, Other International Organizations and Institutions in Financial Reports» (Regulation No. 537), Regulation No. 361 «Regulations on the Additional Underactivity 2.1.2.1.1. «Competence Centres» of the Action Program «Business and Innovations» adopted by the Cabinet of Ministers (Regulation No. 361). As the most significant we should point out the following specific requirements set regarding the conduct of accounting, which should be observed by the CC: the

managed by the industry professionals who assess the vital capacity and economic effect of each potential research project, as well as ensure that these projects achieve the result – the intellectual property. In conformity with the laws and regulations, the CC research programme, which is oriented towards one or several research directions, comprises several industry studies and individual studies. The intellectual property rights, created as a result of industry studies, except for the individual rights of the author or the inventor, which cannot be alienated, are owned by CC. Whereas, if the intellectual property rights are created as a result of individual research, they, except for the individual rights of the author or the inventor, which cannot be alienated, are owned by the person implementing the individual research, i.e. the merchant participating in the CC (Regulation No. 361 The Cabinet of Ministers of the Republic of Latvia, 2010, para 5.3 35. 35.1).

On the whole, while assessing the fields of CC activities in Latvia, the author agrees to the point of view expressed by A. Breiksa that at present in Latvia there are CC functioning only in the sectors of high economic priority, for example, pharmacy, chemistry, biotechnologies. From the aspect of the economic development of the State, it would be necessary to develop the CC network, including into it also the regional centres and higher education institutions, where one of the main objectives shall be the economic and social integration of innovations (Breiksa, 2011, p. 14).

2. The Analysis of Accounting Requirements set for the Competence Centres in Latvia

While performing accounting the CC in Latvia shall observe both generally applicable fundamental principles of accounting and also take into account the specific requirements set for

income and expenses related to the performance of research shall be separated, the intangible assets shall be developed in compliance with IAS 38 «Intangible Assets», and the financial statements shall be prepared in conformity with the provisions of Regulation No. 537.

Having studied the regulations of Latvia regulating the conduct of accounting at the CC, the author established the following main unsolved issues: 1. there has been determined the contradictory research costs accounting policy; 2. the procedure for the recognition of income and expenses has not been clearly defined in all cases.

Since one of the aims of CC activities is to create new products and technologies as a result of long-term projects, it is important to register and disclose in the financial statements their expenses. In the accounting theory the registration of these processes is called research and development costs accounting. In relation to the CC research costs accounting policy in Latvia there have been contradictory norms adopted – on the one hand the Regulation No. 361 provides that there shall be the provisions of IAS 38 included into the accounting policy of these centres (para 84.1.), which prohibits the capitalization of research costs, on the other hand the same document provides for the capitalization of research costs (para 35.5.). There is considerable contradiction regarding both the prohibition to capitalize research costs, which is provided in Section 18 of the Annual Accounts Law of Latvia, and the accounting policy adopted in general on the international scale (see Table 3).

Research costs and development costs are closely linked to one another. Research phase is characterised with a high level of risk, as it is impossible to predict the likelihood of obtaining a positive outcome to be developed for practical application.

Development phase, in turn, is founded on the results of research phase, and it serves as an assurance that the enterprise will be able to obtain a product ready for production or practical application. It is important to differentiate between the two, because, as we can see in Table 3, the dominant accountancy policy depends on the action performed. In the sources studied the costs accounting method of research stage is their recognition as expense when incurred. The immediate writing off policy regarding research costs complies with the principle of prudence, because, as it was mentioned above, the

Activities to be supported	Maximum possible public financing		
	Micro and small merchants	Medium merchants	Large merchants
Industrial research	70	60	50
Experimental development	45	35	25
Project management costs	50%, but not more than LVL 46,854/or € 66,667		

Source: Author's design, using the Regulation No. 361 adopted by the Cabinet of Ministers of the Republic of Latvia in 2010

Tab. 3: Accounting Policy regarding Research and Development Costs

Intangible items	EU Parliament Directive 2013/34/EU	IAS No. 38	UK GAAP	US GAAP	Latvia GAAP
Research costs	expense	expense	expense	expense	expense, except CC
Development costs	assets, in so far as national law permits their being shown as assets	assets, if specified criteria are met	if specified criteria are met, <u>may choose</u> : 1) assets, or 2) expense	expense, except: computer software developed for sale	assets, if specified criteria are met

Source: Author's design, using EU PD; IASB. IAS 38; ASB. SSAP 13; FASB. SFAS 86; Latvia. Annual Accounts Law, Regulation No. 361 adopted by the CA

research activities are related to a high degree of uncertainty – it is not clear, whether there would be the positive outcome that could be utilized for further developmental activities, and thus it is not clear, whether this action would provide companies with the flow of economic benefit in future.

The author finds that it is necessary to specify of Regulation No. 361 (para 35.5) according to the essence of requirement set in this paragraph. Namely, it should be determined that CC capitalizes only the development costs and formed the intangible assets in conformity with the provisions of IAS 38.

The accounting policy in Latvia regarding the financing received from the EU Structural Funds is provided by Regulation No. 537, which regulates also the fundamental principles for the recognition of income related to the CC research projects. The received financing shall be included into the income for the accounting year, when it had been received (para 5), or disclosed in the balance sheet as deferred income, if money is envisaged for the financing of long-term investments, or it would be used during the coming accounting period, or, if the conditions are not fulfilled, the money shall be repaid during the coming years (para 6). The financing recognized as deferred income shall be included into the income for the accounting years according to the fact, why such deferred income had been recognized. Thus it is recognized as income during the useful economic lives of the financed long-term investment or in conformity with the use of granted financing – for the set goals, or during the fulfilment of conditions related to the granted financing (para 9).

The author finds that theoretically in the Regulation No. 537 there have been clearly defined the conditions for the recognition of the financing received from the EU Structural Fund as the income. However, as has been emphasized by I. Liepina, in practice there is a situation in Latvia, when the expenses of the EU financed projects incur in one year, but the financing for such expenses is received in the next year before or after the approval of the annual report (Liepina, 2010, p. 12). While studying the legislation regulating accounting in Latvia, it was established that there is a lack for the detailed normative regulation, how the beneficiary of the EU financing, including also CC, shall recognize the income and expenses.

According to the author, in such cases there should be strictly observed the principle of accrual basis, i.e., the income and expenses related to the accounting year shall be recognized irrespective of the date of payment and the date of the receipt of invoice of the date, when it had been written out; besides, the costs and income shall be reconciled within the respective periods.

In the cases, when the expenses of the CC projects financed by the EU incur in one accounting period, but the financing for their compensation is received in the next period, then the reconciliation of expenses and income depends on the moment, when the financing is received. If the financing is received before the date, when the report for the previous year is being approved, then it shall be recognized as the income for this period and there shall be the correction of the financial statement performed for the previous year – the expenses of projects shall be recognized in the balance sheet as the costs of the coming period and included into the expenses of that

period. If the financing has been received after the approval of the annual report for the previous year, then it shall be recognized as the income for this period and there shall be no correction performed in the financial statement for the previous year, because by the date, when it was approved, there was no sufficient information, whether the financing would be received. Such accounting policy results from the general requirements set by IAS 10 «Events after the Reporting Period» (IAS 10) and Regulation No. 488 «Regulations for the Application of Annual Accounts Law».

The situation changes, if the financing for the compensation of CC expenses have not been received, but it is known for certain that will be received. It means that CC has submitted IDAL the request for payment – the documentation for the approval of eligible costs and CC has received the administrative decision on the approval of financing. In this case the credibly anticipated EU financing shall be recognized as the income of the period, when the related project expenses have incurred, and this shall be disclosed in the balance sheet as the accrued income.

The author suggests supplementing of Regulation No. 361 (para 84.1), which provides for the introduction of requirements set in IAS 38 into the CC accounting policy, with the norm to include into the accounting policy also the requirements set in IAS 10. As well as it is necessary to envisage the cases in Regulation No. 537, when the beneficiaries of the EU financing, including also CC, recognize this financing in their balance sheet as the accrued income.

Conclusions and Suggestions

1. The new and specific formation of business – CC – emerged on the international arena in the USA in 1985. In Latvia the EU Structural Funds programme «Competence Centres» started its activities in 2011 – almost 10 years later than it happened in Estonia.

2. At present there are six CC functioning in Latvia only in the sectors of high economic priority: chemistry and pharmacy, information technologies, forestry, electronics, environment, biotechnologies, bioenergy and engineering industry. After the year 2015 it will be possible to perform the first assessment of the efficiency of CC in Latvia on the whole.

3. The legislation regulating the accounting in Latvia provides information only about the general basic principles for the registration of the EU financing: the registration of the granted financing and its disclosure in the financial reports, as well as the recognition of income and expenses.

4. The specific accounting requirements set in Latvia for the CC, which are related only to the registration of intangible assets (including research and developmental activities) and some contradictory matters regulate the contents of accounting policy.

5. As the main issues, which have not been solved yet, we should point out that in the Regulation No. 361, there has been determined the contradictory accounting policy in relation to the CC research costs, namely, there has been requested their capitalization, which is in considerable contradiction with both the Annual Accounts Law of Latvia and the internationally accepted accounting policy in relation to these costs. And the procedure for the recognition of income and expenses has not been clearly defined in all cases.

6. The author suggests to specify and supplement the Regulation No. 361, namely, to determine that the CC capitalize the development costs and develop the intangible assets in conformity with the provisions of IAS 38, and to envisage that it is necessary to include the provisions of IAS 10 into the accounting policy of CC.

7. It is necessary to determine in Regulation No. 537 that the credibly anticipated EU financing shall be recognized as the income of the period, when the related project expenses have incurred, and this shall be disclosed in the balance sheet as the accrued income.

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