

Annual closing of accounts for 2003 under Bulgarian National Accounting Standards (BNAS)

By means of this paper we would like to draw your attention to the main issues, which in our opinion should be included when planning the annual closing of accounts for 2003.

I. Preparation of the annual financial statements for 2003 in accordance with the requirements of BNAS 1

BNAS 1 stipulates that the complete set of annual financial statements includes the following components: balance sheet, income statement, equity statement, cash flow statement, notes.

BNAS 1 describes the contents of the balance sheet, income statement and equity statement and provides examples of formats for these statements. The format and requirements for the preparation of the cash flow statement are provided in BNAS 7.

We would recommend that the entity perform a review of the balance sheet, income statement, cash flow statement and equity statement formats applied so far and to adapt them, in line with the specifics of its activities, in compliance with BNAS 1. This would also include addition or summarizing and/or change in the classification of the individual items within the frames of the standard groups of formats.

Notes to the financial statements, following Art. 19 of BNAS 1, shall include more detailed description or analysis of the information, presented in the balance sheet, income statement, equity statement and cash flow statement as well as disclosure of the additional information that is not presented elsewhere in the financial statements but it is necessary for the fair presentation and for the total understanding of the statements.

II. Fixed (non-current) assets:

The most significant issues related to the non-current tangible and intangible assets, including the tax depreciation plan, are presented in a separate material of ours.

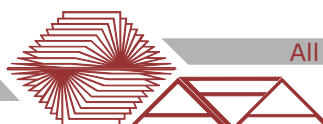
III. Inventories

The most important issues in the accounting and presentation of inventories on which we would like to draw your attention, can be summarized as follows:

1. Cost of purchase of inventories

The scope of expenses, included in the cost of purchase of the inventories, is stipulated in BNAS 2 (expenses on purchase, expenses on conversion, etc.) and we would recommend that the entity performs a review of the adopted policy for formation of the cost of purchase taking into consideration the requirements of the standard.

2. Cost of goods produced



The rules for establishing the cost of conversion (the general requirements for calculating the costs of finished goods) are provided for in points 6 and 8 of BNAS 2. One of the main requirements of the standard is to determine the so called **normal capacity** of the production facilities on the basis of which allocation of the fixed production overheads should be made (in accordance with paragraph 6.3 of BNAS 2). The standard requires that when non-productive overheads exist, they shall be accrued as current expenses and not as part of the cost of production.

3. Valuation of inventories at the end of the reporting period

The inventories shall be valued at the lower of the cost purchase and the net realizable value while the difference between them is reported in the income statement. In this respect, it is necessary that a review of inventories is made at the year-end and their net realizable value is determined with the objective to establish the existence of indications and conditions for impairment.

In addition, we draw attention to the fact that for the inventories owned by the entity, which are intended to be input into production (evidenced in the production schedule), the valuation and respectively the need for impairment should be made as taking into account the net realizable value of the finished goods expected to be produced therefrom. This issue is not discussed in BNAS but it is considered in International Accounting Standard 2, paragraph 29. The cases when certain quantities of inventories have a selling price guaranteed through signed contracts, are treated analogously. Their impairment shall be assessed taking into consideration the contracted selling price less the estimated costs of sales.

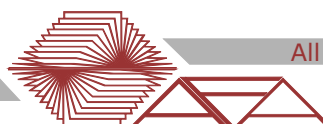
4. Disclosure

BNAS 2 (paragraph 12) stipulates certain disclosure requirements related to inventories.

IV. Receivables (financial assets) and payables (financial liabilities)

The definition, classification and measurement of receivables are provided in BNAS 1 "Presentation of Financial Statements" and BNAS 32 "Financial Instruments" as they meet the definition of financial assets. All receivables (not only the trade ones) shall be reviewed for impairment in accordance with BNAS 32. Therefore, an overall review and assessment of **all receivables** should be made from the point of view of the actual possibilities for their repayment (collection).

1. *Trade and other similar receivables with no fixed maturity* an assessment should be made whether they have not lost partially or completely their characteristics as assets due to the high uncertainty as to their collectability. Their eventual partial or full depreciation or writing off from the assets of the entity should be considered.
2. *Receivables with fixed maturity* comprehensive review of the overall information should be made for the purpose of clarifying the possibilities for their collection within the agreed (or actually expected) terms. The standard requires that these receivables are measured at amortized cost determined under the effective interest rate method. In case the receivables are regular they should be stated at cost (usually their nominal amount as per the invoice). The deferred payments where the incorporated interest for the period has to be detached are exceptions whereas the interest shall be gradually accrued and recognized in the income statement.



3. *The payables held to maturity* (usually bank and trade loans) should also be measured and presented in the balance sheet at amortized cost using the effective interest rate method. Particular attention should be paid to the one-off fees, commissions and other amounts, paid in a single disbursement and/or in addition to the interest as they affect directly the amount of the effective interest;
4. *Trade loans and other similar payables without fixed maturity* should be carried at cost (usually this is their nominal amount). The deferred payments where the incorporated interest for the period has to be detached are exceptions whereas the interest shall be gradually accrued and recognized in the income statement.
5. *Disclosure*
The policy applied by the entity with regards to the recognition and subsequent valuation of receivables and liabilities shall be disclosed in the notes to the annual financial statements.

V. Accounting for provisions and contingencies

BNAS 37 "Provisions, Contingent Liabilities and Contingent Assets" treats important and specific reporting items provisions and contingent liabilities (engagements).

1. Provisions

At the date of the financial statements an analysis should be made as to the existence of obligations (legal and/or constructive), which might necessitate the accounting for provisions in the annual financial statements. The provisions for obligations are recognized only if all of the conditions listed in the standard are cumulatively met.

2. Contingencies

Unlike provisions, contingencies are not recognized in the financial statements as at the date of these financial statements since there is no certainty that present obligation of the entity exists or that they will result in a real outflow of resources from the entity.

3. Disclosure

An adequate disclose of these items shall be made in the annual financial statements.

VI. Employee benefits

1. Short-term benefits

Estimation should be made as at 31 December 2003 (paragraph 3.3.3 of BNAS 19) of the obligation of the entity related to unused paid leaves of personnel (accumulating compensated leaves) and the liability should be accrued in the financial statements.

2. Long-term benefits

They are related mainly to the entity's liability to pay retirement indemnities (in accordance with the effective Labour Code). Since the present value of these liabilities is difficult to determine we would recommend to use the services of certified actuaries.

VII. Income taxes

BNAS 12 regulates the reporting of income taxes. Since the practice for determining and

reporting of deferred tax assets and liabilities is comparatively new in our practice, BNAS 12 itself contains some inconsistencies with IAS 12. Therefore, our recommendation is directed mainly to application of the IAS 12 provisions with priority in cases of contradiction, omissions and inaccuracies.

The balance sheet method is applied for determination of the temporary differences and calculation of deferred taxes. This method requires that accounting and tax balance sheets are prepared as at the date of the statements (31 December). The assets and liabilities are measured and presented in the accounting balance sheet following the requirements of BNAS, while in the tax one the provisions of tax legislation are followed. The differences between these two balances reflect the temporary differences with accrual at the balance sheet date for which reporting of deferred taxes should be assessed (on the basis of the recognition requirements for deferred tax assets and liabilities).

We would recommend that the disclosures of deferred taxes be made in accordance with IAS 12 taking into consideration for this purpose the examples and attachments to the standard.

VIII. Recognition of revenues

In case the entity applies the policy of deferred collection of its receivables from clients, we would like to draw your attention to the fact that BNAS 18 requires that the following be reported and presented individually in the income statement:

the revenues from sale of the respective finished product (goods);

the interest revenue, related to deferred payment.

IX. Changes in the accounting policies

In relation to the serious transition, which the Bulgarian accounting legislation is undergoing, it is very probable that most entities should be forced to reconsider and change their accounting policies. BNAS 8 suggests two possible approaches when reporting changes in the accounting policies: benchmark treatment and allowed alternative treatment. The entity has to choose between these two approaches while the rules for their application are provided in paragraph 8 of BNAS 8.

The entity should disclose: the character of the change and the items it affects; the reasons for the change; the amount of the adjustment for the current and prior period, etc. (paragraph 9 of BNAS 8).

X. Investments

In accordance with BNAS 32 the financial assets of the entity can be classified in *four major categories* (defined in paragraph 9 of BNAS 8).

The *initial valuation* of the financial assets is at cost (acquisition price), which includes the contracted amount for the acquisition of the financial asset (provided in exchange for the financial asset) and the direct expenses for making the deal with it (fees, commissions, etc.).

The classification of the financial assets in the four major categories affects their *subsequent valuation*, which can be: at fair value or at amortized value.

All financial assets should be reviewed for impairment at the end of every reporting period.

Exceptions from the scope of BNAS 32

It shall be taken into account that BNAS 32 is not applied in respect of shares in subsidiaries and associates, which are recognized and valued under BNAS 27 and BNAS 28.

XI. Stock-taking

We would like to draw your attention once again on the requirements stipulated in Section Four of the Accountancy Act regarding the mandatory stock-taking of the entity's assets and liabilities.

In this letter we have only considered the most significant in our opinion issues, which are of material importance to the preparation of the annual financial statements of the entity at 31 December 2003. If you have further questions or would like to discuss any of the issues described, please, do not hesitate to contact us.

December, 2003

