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REPORT

INSTRUCTIONS TO THE UNIFORM CHART OF ACCOUNTS AND THE RESPECTIVE REPORTING FORMS OF DISTRICT HEATING COMPANIES FOR REGULATORY ACCOUNTING PURPOSES

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INTRODUCTION

The following approach is suggested for the development of the Uniform Chart of Accounts for district heating companies (“DHCs”):

1. The instructions to the Uniform Chart of Accounts shall be structured and arranged in accordance with the regulatory accounting information requirements. The main information carriers will be the Balance Sheet and the Income Statement of the DHCs. The information in these reporting forms will be structured and organized in such a way as to allow the State Energy Regulatory Commission (“SERC”) to monitor and assess adherence to the legally established parameters and requirements.

2. The Uniform Regulatory Chart of Accounts of the DHCs will be in compliance with DHC practices and the new requirements arising from the introduction of the International Accounting Standards (IAS). The objective is to apply the mechanisms of the new regulatory framework as precisely as possible and minimize the information-restructuring efforts.

3. The Uniform Chart of Accounts should cover all sections of the National Chart of Accounts. The groups of accounts will be chosen on DHC specifications. Enumeration and titles of sections, groups, and individual accounts will remain unchanged, and new ones will be added on an as-needed basis.

4. Three-, four- and five-digit accounts should be introduced, and the minimum required analytical level should be observed. For the information considered as priorities for the regulatory mechanism, there shall be detailed breakdowns of the accounts that contain this information.

5. The contents of the Instructions to the Uniform Chart of Accounts will cover:

- Balance sheet sections, entries, and accounts from the Uniform Chart of Accounts as carriers of uniform information for regulatory accounting purposes; and
- Sections and entries in the Income Statement and the corresponding accounts from the Uniform Chart of Accounts as carriers of uniform information for regulatory accounting purposes.

ACCOUNTING POLICY

The accounting model adopted for the preparation of the financial statement of the utility will be based on the selected criteria for evaluation and performance, key assumptions, principles, and capital concepts

The objective of this accounting policy is to guarantee reliability of the information contained in the financial statement. For example, in preparing a financial statement, the utility should:

- Provide an objective overview of the financial status and results of the utility;
- Reflect the economic operations and procedures as well as the legal aspects;
- Be neutral and impartial;
- Be cautious;
- Be complete in all material aspects. All major accounting principles shall be observed as stipulated in Article 4 of the Accountancy Act:

1. **Current registration** – expenses and revenues arising from transactions and operations will be entered into the accounts as of the date of occurrence, regardless of the date of actual payment and will be included into the financial statement for the current period. Expenses should be recognized on the revenue bases, by the type of revenue.

2. **Going Concern Company** – the utility must be a going concern with no indications for insolvency.

The utility accounting must be carried out based on documented back-up of all economic facts and operations, comparability of costs and revenues, priority of content over form, and preserving if possible the accounting policy of the previous reporting period.

Financial concept of the capital will be adopted.

The accounting policy adopted by the utility should comply with the Accountancy Act and the National Accounting Standards. On issues for which there are no specific instructions in the national accounting legal framework, the International Accounting Standards should apply.

I. ASSETS

FIXED TANGIBLE ASSETS

All assets that comply with the requirements IAS No 16 will be accounted as fixed tangible assets. IAS No.16 provides: “As an item of property, plant and equipment should be recognized as an asset when: it is probable that future economic benefits associated with the asset will flow to the enterprise or the cost of the asset to the enterprise can be measured reliably.”

Thus, assets will be classified as fixed tangible assets (“FTA”) if they are acquired and managed by the utility, are fixed and tangible in essence, and are expected to be used for longer than one reporting period.

The Fixed Assets regulatory accounting procedures will be based on the following principles:

- FTA at the date of acquisition will be evaluated by the cost of acquisition.
- Costs on loans, (interests, taxes etc.) will not be capitalized / included in the value of FTA.
- Evaluations of FTA after their initial recognition – the FTA are recognized at their historical value, reduced by the depreciation charges and the accumulated loss from impairment. .
- FTA will be written off the balance in the following cases: sale or decommissioning of plant;
- Follow up expenses for FTA – i.e., expenses related to the rehabilitation, reconstruction and modernization, which will increase the useful life of the assets.

FIXED INTANGIBLE ASSETS

The utility will classify assets as fixed intangible assets (“FIA”); if they do not have physical substance and the asset is expected to be used for longer than one reporting period.

The utility could adopt the linear depreciation method for FIA using the depreciation charge in accordance with the Bulgarian tax legislation.

When FIA becomes economically redundant they will be written off, and the revaluation reserve of the written off FIA will be transferred to the retained earnings.

INVESTMENT PROPERTIES

Investment properties of the utility consist of buildings and structures not currently in use but held for long-term use, and any lease revenues.

The initial evaluation of investment properties will be conducted at acquisition price. Any further expenses related to investment properties if reliably measured and leading to accumulation of expected economic benefits will be added to the balance value.

Linear method of depreciation will be applied for all depreciable investment properties at a depreciation rate of 4%, based on Bulgaria’s tax standards.

INVENTORIES (SUPPLIES & MATERIALS)

At the initial acquisition, inventory will be valued at the lower value between the historical and net realizable value. When accounting by historical value, all expenses related to the purchase and acquisition and all other expenses directly related to supply – e.g., supply expenses, transportation costs, delivery, and installation.

SHORT-TERM RECEIVABLES

At their initial occurrence, receivables will be evaluated by their historical value or another value, compatible with the applicable accounting standards. Receivables in foreign

currency will be registered in BGN by applying the official exchange rate of the Central Bank on the date of the transaction.

Receivables will be written off at expiration of the due period, in the case of bankruptcy of a client or another debtor, or when the utility otherwise determines that it will be unable to collect the receivable.

FINANCIAL ASSETS

Financial assets in the utility are receivables that occurred initially within the company and are established by a direct transfer of money, goods or services to the utility under specific legal contracts.

At the end of each reporting period, and in accordance with Item No. 6.4 of the NAS 32, the company will reevaluate these receivables and if there are objective grounds for devaluation, will determine the recoverable value and register the difference as current cost.

CASH

The official cash will be evaluated by its nominal value. The cash in foreign currency will be evaluated at the exchange rate of the date of acquisition. On the date of the annual financial statement a revaluation will be carried out with reference to the Central Bank exchange rate as of December 31, 2004.

DEFERRED COSTS

Costs that are not related to generating income for the reported period will be accounted as deferred costs/expenses. For the period when the company recognizes the deferred costs as current costs for the regulated activity, the deferred costs will be recorded, according to their specificity, in the debit accounts of the group "Expenses by Economic Elements." These costs will be recognized in proportion to the benefits received, and shall include insurance, subscriptions, taxes, and other costs.

DEFERRED TAX ASSETS

In the balance, such assets should be recorded separately from the current tax assets. Deferred tax assets are amounts from recoverable taxes on profits for future periods with respect to:

- Reduction of temporary differences;
- Transfer of non-occurred tax losses;
- Transfer of unused tax credits. Deferred tax assets will be evaluated on the basis of tax rates in force at the date the balance is prepared. They will be adjusted for the next reporting period whenever there is a change in the tax rates. They shall be written off upon loss of the right to be recognized.

II. LIABILITIES

Liabilities at their initial occurrence shall be evaluated by their historical value or a different value in accordance with the applicable accounting standards. The utility shall classify

liabilities into (a) short-term and covered within 12 months from the balance date and (b) long-term to include all remaining liabilities.

DEFERRED INCOME

Deferred Income shall be classified either as long- or short-term liabilities, depending on the term of recognition as current revenues.

Revenues received by the company during the reported period that are related to costs that shall be incurred over later reporting periods shall be accounted as deferred income.

POSTPONED TAX LIABILITIES

Certain profit tax on taxable temporary margins will be recorded as liabilities on postponed taxes, separately from the current tax liabilities.

These shall be evaluated according to the applicable tax rates at the date of the balance.

III. REVENUES

Revenues shall include the gross flow of economic benefits accumulated from regulated activity during the reporting period, when this flow results in increased equity above and beyond the increase of the share capital.

The revenue arising on a transaction is usually determined by agreement between the enterprises and the buyer. It is measured at the fair value of the consideration received or receivable taking into account the amount of any trade discounts and volume rebates allowed by the enterprise.

FINANCIAL INCOME

Financial income is related to the use of company resources by third parties (servicing banks).

Interests are recognized as income at the time they are received.

Current financial income will include positive differences resulting from revaluation of currency assets and liabilities.

IV. EXPENSES

Expenses will be recognized in the Profit and Loss Statement (“PLS”), when there is a reliable, measurable decrease of economic profit, related to reduction of assets or accumulation of liabilities. Expenses will be immediately recognized when no profit is expected in the future.

Expenses for the regulated activity shall include expenses reported by economic elements, adjustments, and financial costs.

The utility shall classify expenses by economic elements as operating costs and expenses for supporting activities.

Operating costs (direct and indirect) are part of the historical value of company assets. Expenses for supporting activities shall include sales and marketing expenses and general and administrative expenses.

FINANCIAL EXPENSES

Financial expenses are related to debt capital of the Company (loans).

Interests on financial expenses will be recognized as current financial costs at the moment of payment.

Current financial expenses shall include negative differences resulting from revaluation of financial assets and liabilities in foreign currency.

EXTRAORDINARY INCOME/EXPENSES

Extraordinary entries/accounting categories (income/expenses) are the result of operations and activities that are clearly outside the scope of the regulated activities of the company and are of infrequent or accidental character.

Extraordinary income/expenses shall be accounted for in the Income Statement separately from income/expenses for the regulated activity, as a total amount for all extraordinary operations/activities. The type and the amount of each entry will be reported separately.

NET FINANCIAL RESULT

The net financial result for the reported period will be based on the determination of profit or loss from the activity for the reported period (usually calendar year) and the recognized income and expenses will be included in the company's Income statement.

The net financial result for the reported period shall include:

- Profit and loss from the regulated activity.
- Profit and Loss from extraordinary activities. The extraordinary activities are existing as an accounting category for all type of business. The Companies in the Energy Sector are identifying the extraordinary expense with the non-regulated activities.

FUNDAMENTAL ERRORS

These are errors identified by the company over the current reported period that are of such importance that the financial reports for one or more preceding periods could no longer be considered accurate and reliable at the date of their publication.

PROFIT TAXES

Accounting of profit taxes, temporary differences, and their tax effects will be performed according to the stipulations of the NAS 12 (Profit Taxes).

Approval of current tax expenses will be performed on the basis of their inclusion in the group of costs for the reported period. In this way, the accounted profit will be decreased and the accounted loss will be increased. Tax rates, applicable at the date the annual financial report is prepared shall be applied to the taxable profit.

V. FINANCIAL STATEMENT

The financial statement represents the fair and objective evaluation of the property and the financial status of the company, the reported financial results, changes in the equity structure and cash flows that shall be prepared after evaluation of assets and liabilities in compliance with the provisions of chapter four of the Accountancy Act.

VI. EVENTS, OCCURRING AFTER THE DATE OF ISSUING OF THE ANNUAL FINANCIAL STATEMENT

According to the NAS 10, events that have occurred after the date of the annual financial statement may include:

- Adjustments for conditions which occurred by December 31st; and
- Non-adjustments for conditions which occur after December 31st.

Events leading to adjustments occurring in the period from the issuing of the annual financial statement until official approval for publication will be recorded in the financial report by correcting the respective entries.

Events not leading to adjustments are reflective of conditions arising after issuance of the annual financial statement. These do not require adjustments in the financial statement but should be noted in the attachment/annex.

VII. ACCOUNTING DOCUMENTS

The accounting documents and ledgers shall be carried out in compliance with the provisions of the Accountancy Act and the accounting unbundling by type of activities, regulated and non-regulated activities, as well as the customers groups will be carried out in accordance with the Energy Law and the Secondary Legislation requirements. .