



## Accounting interpretation of concession rights in the Republic of Bulgaria – topical issues

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### Abstract

The subject of this paper covers the topical problems for the Republic of Bulgaria on the recognition, presentation and disclosure of concession rights and transactions for accounting purposes. The issues identified by the authors have a regulatory, theoretical character and concern their practical application. The aspects studied within this paper are: recognition of concession rights as intangible assets and their positioning in the total amount of assets of concessionaire enterprises; requirement and readiness for disclosure of information relating to concession agreements. The authors seek to suggest solutions in the specified directions.

**Keywords:** concession rights, concession agreements, accounting, intangible assets, public-private partnership, disclosure, Annual Financial Statements.

### Streszczenie

#### Ujęcie koncesji w księgach rachunkowych i sprawozdaniach przedsiębiorstw w Bulgarii

Artykuł obejmuje zagadnienia i problemy istotne w Bulgarii, związane z pomiarem i ujmowaniem koncesji w księgach rachunkowych oraz prezentacją w sprawozdaniach finansowych. Wnioski mają wymiar zarówno teoretyczny, jak i praktyczny. Autorzy starali się wypracować rozwiązania mające na celu właściwą prezentację tych praw, uwzględniając zarówno wymagania użytkowników informacji, jak i regulacje prawne.

**Słowa kluczowe:** koncesje, umowy koncesyjne, rachunkowość, aktywa niematerialne, partnerstwo publicznoprawne, ujawnianie, roczne sprawozdanie finansowe.

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## Introduction

According to the regulation control in the country „a concession is the right to exploit a facility and/or a service of general interest, conceded by a concession granting authority to a person engaged in commercial activity (a concessionaire), against the concessionaire's obligation to construct and/or manage and maintain the subject of concession or to manage the service at concessionaire's own risk” (Law on Concessions, 2006, art. 2). A concession is granted on the basis of a long-term written agreement of a particular material interest executed between the concession granting authority and the concessionaire. The main aim and purpose of a concession agreement is the sharing of benefits, risks, responsibilities and control between the parties under the agreement. Depending on its object, the agreement can be concluded for: public works concessions, service concessions and mining concessions.

In order to have this study applicable at national level and compliant with international practices at the same time, it has been focused on identifying the differences in the regulatory frameworks and finding ways in adapting suitable practices and solutions from around the world for the concessions and their accounting recognition. In this respect, four legal approaches for concession execution could be differentiated:

- a codified (systemized in a single legislative act) one-tier system of the legal framework (Hungary, Bulgaria);
- a non-codified one-tier system where there are many special laws, out of which one has a more general nature and the others elaborate on its specifics in concrete areas according to specific features of the subject (Spain, Sweden);
- a non-codified one-tier system which includes special legislation in a framework (United Kingdom, Germany);
- a non-codified multi-tier system with a legal and regulatory nature (Switzerland, Belgium, France, Belarus, Russia). In the latter countries, there is no single law dealing with the concession's conditions and the procedure of its implementation, but the regulatory framework is very detailed concerning the usage of the concessions and related activities in respective fields.

There are two main approaches for concession execution – licensing and contractual. The Licensing approach is applicable in Germany, Switzerland and Russia. According to this approach, the act of giving the concession is an administrative one and expects authoritative juridical relations between the parties – the competent body does not negotiate but allows, and activities are the subject of administrative control, and not a court one.

The Contractual approach is applicable in most of the EU countries, including Bulgaria. According to this approach, there is a binding agreement between the respective competent State authority and the concessioner that contracts a specific right for use of objects/fields, for which the State withholds exclusive ownership, for good and valuable consideration and for a limited duration. Both parties are treated equally and have correlative rights and obligations, stipulated in the contract and in compliance with the legal framework.

Based on this study we can conclude that in Bulgaria the regulatory legislation of the concessions is harmonized with international practices, as they apply a codified system and contractual regime. In contrast to international practice, concessions in Bulgaria granted under the conditions of, and according to the provisions of the national Law on Concessions and the Law on Subsurface Natural Resources, are not a public private partnership (Law on the Public Private Partnership, 2012, art. 3 par. 3). Regardless of the regulatory framework and the subject of activities, upon conclusion of an agreement, some rights (intangible asset) originate for the concessionaire, with which the concessionaire shall increase the total amount of its assets. Such rights are subject to amortization for the term of the agreement which could be up to 35 years, without an option for extension. In the course of the implementation of the agreement and while exercising the rights, the reporting entity concessionaire shall have to create information about the generated financial and material assets, costs and revenues in connection with the accomplishment of the commitments undertaken, as well as about the concurrent environmental programs. Unfortunately, the national practice with regard to concession transactions have already exceeded the national accounting theory and practice as well as the presentation of concession rights and the reporting of concession activities for the purposes of financial reporting. The authors have identified problematic issues at different stages of concession transactions and activities. This study aims to present the problems and elaborate on the possible solutions regarding:

- recognition of concession rights as intangible assets and their positioning in the total assets of concessionaire enterprises;
- requirement and readiness for disclosure of information relating to concession agreements in the Republic of Bulgaria.

The research methods used in this study are of general significance and traditionally applicable, and are: the historical and logical method, the comparative method, the method of observation and monitoring, and the regulatory approach.

## **1. Concession rights as an accounting item**

A concession right, in its essence, is an intangible resource acquired and controlled by the concessionaire for the purpose of realizing future economic benefits. The concessionaire does not obtain ownership of the fixed tangible assets subject to concession but rather acquires specific rights over them (rights to exploitation under certain conditions, rights to construct, or rights to perform services of general interest), which allow the concessionaire to generate economic benefits. Contradictions in the national accounting theory and practice regarding the classification of concession rights as intangible assets, provided that some threshold criteria are met, actually do not exist.

The problems stem from the misunderstanding of their nature and their inclusion in classification classes such as „industrial property rights” or „intellectual property

rights". Or *vice versa*, from the incomprehension of the essential characteristics of the items pertaining to internationally adopted and established groups such as „industrial property rights" or „intellectual property rights", as a result of which concession rights are made equal to items such as patents, geographical indications, copy rights, *etc.* Regardless of the variant, the result is the same: an indistinct accounting item – inadequately generated accounting information. Why are concession rights out of place in both groups? According to the Convention establishing the World Intellectual Property organization (WIPO) of 1967, the two main groups of intellectual property are: industrial property items (Paris Convention for the Protection of Industrial Property of 1883) and literary, artistic and scientific works (Berne Convention for the protection of literary and artistic works of 1886). Therefore, industrial property rights constitute part of intellectual property rights, and not items outside their scope. By definition, they constitute rights on: patents for inventions, licenses, useful models, industrial design, factory marks, trademarks and service marks, trade names, names of the place of origin of goods, indications of origin, indication of provenance, and prosecution of unfair competition. As a result of the conclusion of some additional international agreements, such items have been added to the scope of intellectual property as rights on selection achievements, biotechnology, topographies of integrated circuits, software products, topographic signs, the development and maintenance of websites on the Internet and others (Borisov, 1999, pp. 9–12). But none of the classification groups includes the right to exploitation of, and construction on, assets owned by the state, a municipality or a public partnership, nor the right to provide services of general interest. Why? Because concession rights do not originate in the intellectual activity of man, they are acquired for the purpose of managing public, state or municipal property or providing services of general interest. In order to summarize what has been laid out so far, it has to be underlined that regardless of the origins of the problem, the indispensable consequence is that when the essential characteristics of an accounting item are not understood (concession rights in this case), it is impossible to create an adequate model for its accounting treatment and presentation in annual financial statements – a model which is supposed to interpret the specifics of concession activities, concession fees payment method, the generation of financial and tangible assets, costs and revenues relating to this activity, as well as the results of it from an accounting perspective.

In order to be able to correctly determine the problems in the accounting theory and practice with regard to concession rights, it should be highlighted that two accounting bases are applicable to non-financial enterprises in Bulgaria – national (NFRSSME) and International Accounting Standards (IAS), and the International Financial Reporting Standards (IFRS) respectively. Large enterprises apply the basis of IAS/IFRS. Small and medium-sized enterprises are entitled to choose between the national and international standards. For those enterprises applying NFRSSME, only the National AS 38 *Intangible Assets* is applicable with respect to concessions. There

is no specific standard or guidance on concession transactions. The problem is that the accounting framework for small and medium-sized enterprises was regulated with the NFRSSME adopted in 2008, which, as at that date, were adjusted to the international accounting standards to a maximum degree. The provision, according to which an SME can choose to apply IAS as well, was included in the Accounting Law. At that stage, adequate European and international accounting harmonization and organization for SMEs was ensured to a maximum degree in the country. Significant and substantial changes occurred in the global, European and national context over the period following the year 2008 to the present day. These changes could not find an equivalent in the applicable Bulgarian accounting legislation. The national regulatory framework in the field of accounting after 2007/2008 remained in a latent condition. A much more dynamic conceptual framework would be IFRS for SMEs, the introduction of which is being debated within the accounting guild, yet without a single statement on it. And last but not least, it should be noted that, in line with the provisions of NFRSSME, the format of the presentation of accounting information in tax returns and annual financial statements, including the information on concessions, is subordinated to the format required by the National Statistics Institute. Accounting purposes take second place. Concessionaire enterprises applying IAS/IFRS have a broader accounting basis including: IAS 38 *Intangible Assets*, IFRIC Interpretation 12 *Service Concession Arrangements*, IFRS 6 *Exploration for and Evaluation of Mineral Resources*; SIC Interpretation 29 *Service Concession Arrangements – Disclosures* /as amended by Commission Regulation (EC) No. 254/2009 of 25 March 2009/; *Guidelines on Accounting of PPPs 2008*. Enterprises in the public sector do not apply International Public Sector Accounting Standards, IPSAS 31 *Intangible Assets* or IPSAS 32 *Service Concession Arrangements*. They apply a Guidance of the Ministry of Finance DDS No. 20/14.12.2004 on the application of the National Accounting Standards by the Budgetary Enterprises. The provisions in this Guidance concerning intangible assets refer to NFRSSME for non-financial entities. Moreover, according to the effective Law on Accounting, public sector enterprises do not amortize/depreciate their non-current assets. There is a National Chart of Accounts for budgetary enterprises (its latest update in DDS 14/30.12.2013) the application of which is mandatory. It prescribes the accounts to be used as well as the accounting procedures for the individual accounting items. This mandatory approach when building the system of public sector accounting is also reflected in the national accounting theory in this field. Therefore, if it should be summarized, the problems on a national level connected with the recognition of concession rights on accounting items can be localized only for enterprises applying NFRSSME and for public sector enterprises. NFRSSME 38 *Intangible assets* determines the group as „Concession rights acquired according to the proper legislative arrangements” (p. 9 c), i.e. the regulatory accounting framework follows the provisions of the regulatory acts. The problem here is not only the leading

regulatory principle of the conceptual framework, but also that the regulatory accounting framework has been transposed in handbooks and publications of accounting theory. The situation with the practice, which is guided by the regulatory accounting documents, is no different as well. An example in this respect is the National Chart of Accounts adopted in 1998 and repealed in 2002. Though repealed, it still serves as an example in the practice of setting up enterprises' individual charts of accounts (*Practical Handbooks of Accountants 2014*). The structure of group 21 *Intangible Assets* involves six accounts from which it becomes obvious that the essential characteristics of intellectual property items are not sufficiently known, nor the specifics of concession rights. The main (aggregate) accounts are: 211 „Establishment and expansion costs”, 212 „Products from development activities”, 213 „Intellectual property rights”, 214 „Software”, 215 „Industrial property rights” and 219 „Other intangible assets”. A separate account to record the acquired concession rights has not been envisaged. They come within the content of account 215 „Industrial property rights” and to be more specific:

- „long-term permissions (above 1 year) for prospection and/or exploration of sub-surface natural resources;
- other long-term permissions, provided by state or municipal authorities, required by law for the accomplishment of certain activities, for the usage of certain assets, for the performance of activities in distinct areas, *etc.*;
- concessions for production of subsurface natural resources;
- concessions for usage of coastlines;
- concessions for usage of biological, mineral and energy resources;
- concessions for usage of national roadways, harbours and airports;
- concessions for usage of waters, *etc.*”.

In fact, account 215 „Industrial property rights” comprises concession rights and not a single item of the industrial property group, which is internationally approved and adopted by the World Intellectual Property Organization. The inference is that neither the accounting theory, nor the accounting practice in the non-financial sector can distinguish between the essential characteristics of the separate groups of intangible resources. Hence, the other problem – one and the same accounting treatment methodology for rights which are different in economic substance, as well as for different forms of the realization of economic benefits (patents and licenses for industrial property rights and public property management) resulting from them. Just as big a problem is the analogy which is made between the accounting interpretation of intangible and non-current tangible assets – reporting entities' resources different in their economic nature. There is a common definition in the accounting theory that states: „intangible assets are accounted for in an analogical manner as fixed assets.” As far as the presentation of concession rights in the annual financial statements is concerned, the groups of intangible assets within the form of the balance sheet for the year 2014 preserve the indistinctness of intangible resources and make them obscure:

**Section B: Non-current assets****I. Intangible assets**

02110 Development products

02120 Concessions, patents, licenses, trademarks, software products and other similar rights and assets including:

02121 for water power plants

02122 for wind power generators

02123 for solar collectors

02124 for thermal pumps

02130 Goodwill

02140 Advance payments and intangible assets under construction

**02100 Total of group I**

It is striking that the principal criterion for the presentation of information in the main and „mixed” group of intangible assets, 02120, is a type of energy source, not a type of resource. It is also questionable whether all intangible assets could be linked to an energy source and whether the information that has to be brought to the fore is exactly this one. Such an approach of accounting information presentation does not facilitate the accomplishment of financial accounting analysis on behalf of the enterprises and it confuses the users of such information with regard to the composition of intangible assets, their evaluation, as well as about the residual value of the specific assets as of the date of preparing the statements.

Similar are the practices and considerations in publications on public sector accounting, which are based on the regulatory guidance in DDS 20/2004 and DDS 14/2013 of the Ministry of Finance (*Handbook of Budgetary Accountant 2014*). Only three accounts have been prescribed for the accounting treatment of intangible assets: 2101 „Software products”, 2102 „Patents, licenses, concession rights, company marks and trademarks, etc.”, and 2109 „Other intangible assets”. The differences are completely eliminated for public sector enterprises. DDS No. 20 of 14.12.2004, on the application of the National Accounting Standards by the Budgetary Enterprises, specifies that „the provisions of National Accounting Standard 38 *Intangible Assets* are generally applicable to the budgetary enterprises.”

For the purpose of overcoming the constantly multiplying, incorrectly adopted accounting terminology for groups of intangible assets and accounts, the author suggests that the following classification classes of intangible resources should be introduced to reflect the real essence of the types of rights:

- intellectual property rights – industrial property rights, copyrights and related rights, new items of intellectual property rights;
- limited proprietary rights;
- concession rights.

Thus, the concession rights could be adequately presented in the amount of total assets of non-financial and public sector enterprises. It would be possible to apply

a special methodology for their accounting treatment and presentation in the annual financial statements, depending on their subject and on the method of payment of concession fees (some examples of accounting models for concession transactions have been worked out by Markova, 2014, pp. 110–173).

Another problem of no less importance in the recognition of concession rights is their evaluation and the reliability of its measurement. The practices prescribe that their initial evaluation should be composed only of the charges paid when applying for the conclusion of a concession agreement and of the firmly agreed concession fees. The fixed concession fees are minimal as a rule and usually a concession transaction is associated with a percentage of future revenues obtained as a result of exercising the acquired rights. Such additional concession fees, however, are treated as current expenses for external services, not as an element of concession rights. In this case, accounting practice can't keep pace with accounting theory (Basheva *et al.*, 2012, pp. 103–146; Markova, 2014, pp. 110–173). The quoted authors have elaborated specific techniques for the reliable measurement of concession rights evaluation, which is expected to include all of their real components. The only thing that remains to be done is for the accounting staff to become familiar with these techniques and accounting models and to actually apply them.

## **2. Disclosure of information on concession agreements in the Republic of Bulgaria**

Concession agreements are, as a rule, associated with long-term relations which cause the generation of accounting information both in the public sector (ministries, municipalities) and in the private sector. Such relations concern not only the participants in them but society as whole. They may seek infrastructure improvement, the creation of a better social environment, or optimum usage of natural resources in a given region. At the same time, a very important condition for the favorable development of these relations is that they should be set up in conformity with the regulatory requirements, should not create prerequisites for corruption and should not threaten the environmental balance. In this connection, the accounting information that has to be disclosed by participants in these relationships is of prime importance.

A National Concession Register has been established in the Republic of Bulgaria, in which all the planned and concluded agreements have to be published. The arrangements of generating and organizing the information in the register are provided separately in chapter 11 of the Law on Concessions (2006, art.96–101). The register contains economic information which may be used by the users to determine a number of indicators. An analysis of trends could be conducted with regard to procedures successfully and unsuccessfully carried out for the selection of concessionaires, analysing trends on the interest in the respective types of concession – construction, ser-



vice or mining concession, the mechanism preferred in determining the concession fees by the concession awarding authority, to analyze the amount of participation and implementation guarantees as a relative share of the concessionaire's income, the tendency on the feasibility of investment by year, etc. However, in the context of accounting, this register is a valuable source of information for the participants in concession relations, which are identified by their unique identification code (UIC) and name, which can be used to perform a verification in the system of the Registry Agency. The annual financial statements of private partners in concession relations can be observed at the Agency. Part of the concessionaires apply NFRSSME, another part of them – IAS or IFRS respectively. Generally speaking, the concessionaires who apply the International Accounting Standards disclose more information relating to the concession agreements concluded by them, compared to the enterprises applying NFRSSME, but the enterprises rarely provide sufficient systematic, regular, full and exact information about the implementation of concession agreements. This information is not at a sufficiently high level to meet the quality characteristics of the information which is supposed to be contained in the statements, namely clarity, relevance, reliability, consistency and neutrality (Basheva *et al.*, 2009, pp. 87–90). On the other hand, the fact that the Republic of Bulgaria is due to adapt its national legislation to Directive 2013/34/EU should not be underestimated. The effective Accounting Law does not comply with the requirements of the Directive. In this connection, the professional community has developed a new draft of the Accounting Law, which is causing a number of disputes. On the one hand, micro and small enterprises are supposed to be facilitated by the provisions of the new Law, while on the other, the quality of the information published in the annual financial statements is supposed to be preserved. Part of the concessionaires, especially those under service concession agreements, might turn out to be micro or small enterprises. Nevertheless, under concession agreements, they can obtain significant public rights which requires exercising control regarding the accounting information generated in connection with these rights. In this context, we consider that the enterprises of the category of micro and small enterprises, which hold concession rights, should be liable to disclose information about the concession agreements concluded by them and the recognized assets and current income and expenses relating to them. There should be a special requirement about the commitments under such agreements disclosed and non-fulfilled. The requirement of Directive 2013/34/EU concerning the publishing of reports on payments to governments on behalf of the mining industry enterprises, which acquire mining rights in Bulgaria under concession agreements with the states, should not be underestimated as well. These requirements have been completely transferred from the Directive into the new draft law presented for discussion, but would they be observed and how would the control over the implementation at local level be exercised?

The question about the disclosure of the annual financial statements of concession awarding authorities remains unsettled as well. A new Law on Public Finance was adopted in 2014 laying down some fundamental principles<sup>1</sup> in public finance management in the Republic of Bulgaria. One of the principles – the principle of transparency – requires the creation of public awareness possibilities. The transparency prerequisite is created at a municipal level by the requirement to publish municipal annual financial statements on the webpage of the municipality (Law on Public Finance, art. 140). However, the following questions arise: Is this information about concession transactions sufficient for public awareness? Why is it possible for this information to be published by 31 December of the year following the reporting information, given that for the private sector this term is six months shorter (by 30 June of the year following the reporting year)? Does it correspond to the requirements for disclosure of the concession awarding authority's information in conformity with the provisions of SIC Interpretation 29 *Service Concession Arrangements – Disclosures*? How would public access to the information be ensured for the remaining awarding authorities under concession agreements, which are not municipalities? We consider that publishing accounting information on concession activities in the public sector is an exceptionally important condition for exercising public control over transactions awarding exploitation/operation rights of general interest. The lack of public awareness in particular results in preconditions for corrupt practices in this field. In view of the problematic areas associated with concession agreement management, our suggestion is that the information disclosed by the awarding authorities should generate and involve supplementary components such as uncollected receivables from concession fees for the respective year and under agreements, as well as the percentage of the annual concession fees regularly received and the percentage of those in arrears.

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<sup>1</sup>Art. 20 of the Law on Public Finance „Public finance shall be managed in observance of the following principles:

- 1) Comprehensiveness – public finance management shall be carried out through budgets and accounts of public budget financed entities integrated into the consolidated fiscal programme and through observation of the other persons in the General Government sector.
- 2) Accountability – public finance management ensures the accountability and responsibility of the budget spending authorities.
- 3) Adequacy – compliance of the fiscal policy with the macroeconomic and socio-economic objectives.
- 4) Economy – acquisition of the resources needed for the operation of public budget financed entities at the least possible cost, while observing the requirements for quality of resources.
- 5) Efficiency – attainment of maximum results from the resources used in the operation of public budget financed entities.
- 6) Effectiveness – the degree of attainment of the objectives pursued by public budget financed entities established through the comparison between actual and expected results from their operation.
- 7) Transparency – the creation of opportunities for public awareness through public access to information on the macroeconomic and budgetary forecasts, on the on-going implementation of the consolidated fiscal program, as well as on the methodologies/assumptions used in their drafting.
- 8) Sustainability – maintenance of the current levels of revenue and expenditure without risking the solvency of the government or risking the ability of default on a long-term basis.
- 9) Lawfulness – compliance with the applicable legislation, internal acts, and agreements”.

Apart from that, the effectiveness of the management of concession fees in arrears should also be taken into consideration. Thus, the precautionary principle will be observed and no overestimated assets will be reported as receivables. Higher efficiency with regard to the current concession agreements will be achieved, since better awareness would reduce the currently effective agreements under which concessionaires fail to perform their liabilities.

Even though concession relations are regulatorily settled in a separate law, they actually constitute a form of public private partnership (PPP). In this connection, the question of what kind of publicly accessible information will be provided about the PPP agreements concluded in Bulgaria is interesting as well. Legislature has made provisions that a Public Register of PPP should be set up, kept and maintained (Law on Public Private Partnership, art. 4), which shall contain information about the announced procedures, the PPP agreements concluded and implemented. Generally speaking, public information should be generated and presented according to the model of the already effective Concession Register. Nevertheless, there is a problem with regard to the application of the regulatory framework. The Law on PPP was adopted in 2012, but the PPP Public Register has not been established and has not yet started functioning. It is known from the mass media that there are some efforts to conclude agreements under this law but there are no notices and decisions published for the selection of a private partner. Why does the mechanism fail to work? Are the efforts to establish a partnership associated with corruption schemes, and for that reason are illegally concealed? We put special emphasis on these registers because we could obtain from them reliable information about the participants in the public private partnership and could look for information about their annual financial statements annually published at the Registry Agency.

From our point of view, the enterprises participating in concession transactions should disclose more detailed information relating to the accounting information generated by them as a result of the concession relations. The accounting information on concession transactions should be separately disclosed. The more significant issues which have to be reflected in the annual financial statements of participants in concession transactions are: the type and number of concession agreements concluded, the concession rights recognized as intangible assets in an individual group, separate from the other intangible assets, the commitments undertaken by the parties in the context of provisioned liabilities and/or contingent assets/liabilities, an annual report on the engagements fulfilled, stages of engagement completion, and any other significant information, if required, in order to avoid misleading users of statements.

## Conclusion

We could summarize in conclusion that there is a variety of problems associated with the initial recognition of concession rights in the private sector, the organization of accounting for concession transactions in the public sector respectively, as well as

with the disclosure of accounting information. These problems are reflected as mal-practice with respect to public private partnerships as well. According to the authors of the paper, the main problems that have to be solved are: harmonization of the national regulatory framework in the field of accounting with the International Accounting Standards; improvement of the quality of accounting information concerning the initial and subsequent measurement of concession rights; and improvement of the quality of the information which should be published by participants in concession transactions – the concessionaire and the concession awarding authority.

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