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Preparation and disclosure of non-financial statement based on the new bulgarian accountancy act

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Introduction

Historically the concept of announcing non-financial information dates from 60 years ago. Its purpose is to give data of non-financial nature that refers to different aspects of the organization's deeds and essentially brings additional value to whom it concerns. Initially developing and publishing non-financial information by organizations was done voluntarily. The information being announced has been picked and systematized by the organization's managing staff. That causes the non-financial information given by organizations from a particular sector to be limitedly comparable and correctly analyzed.

Specialized literature (Szabó & Sørensen, 2015, p. 312) states that the first attempt of European Commission regulating non-financial information development and announcement dates back to 2003 when Directive 2003/51/EO was introduced. It happens so that this Directive doesn't improve nonfinancial accounting in the organizations (Szabó & Sørensen, 2015, p.312). The European commission still supports a number of programs and strategies with which it aims to increase the transparency and authenticity of nonfinancial data disclosed in the financial statements of enterprises (for more information see: Ivanova, 2015). Commission activities are primarily aimed at improving corporate sustainability and social responsibility of organizations by establishing uniform requirements for disclosure of non financial information. In this regard, in 2014 Directive 2014/95/EC was introduced. The text of the regulatory document provides some significant

changes to Directive 2013/34/EC regarding the preparation and disclosure of non-financial data from organizations. In a particular aspect, enterprises¹ that are companies operating in the public interest, should "include" in their activities report non-financial statement too. Notable requirement is that companies of public interest should meet the criteria for large enterprises² that as of the dates of their balance sheets exceed the average number of employees - 500 people, during the financial year (Directive 2013/34/EC, article 1, paragraph 1). According to Federation of European Accountants provided data the number of enterprises of public interest in the member-states of the European Union (EU) is 27 886 (Definition of Public interest entities in Europe, 2014, p.8). It is believed that the introduced legislative requirement for the preparation of a non-financial statement will affect nearly 6,000 of them (Statement /14/291, 2014).

The amendments to Directive 2013/34/EC relating to the preparation and disclosure of non-financial statement have been transposed in Bulgarian legislation with the adoption of the new Accountancy Act (AA, 2015). In the text of the regulatory document the Legislator provides large public interest entities³ to prepare non-financial statement and to "include it" (AA, 2015, Article 41) in their activities report⁴, starting 01.01.2017.

¹ The legislator has adopted the term "enterprises". According to § 1 from the additional provisions of Bulgarian Law for SMEs "enterprises" mean every natural person, legal person or partnership, that legally carries on business regardless of ownership, legal and organization form. A company is an association of two or more persons for the purpose of conducting business with shared resources. Organization is a group of persons to carry out a common purpose under certain norms of behavior, job hierarchy and legal status. The three concepts shares the idea of a union of persons in a legal form for making profit with common money. On this basis, for the purpose of the paper these terms will be used uniquely.

² Large enterprises according to Directive 2013/34 / EU are enterprises which at the dates of their balance sheets exceed the limits of at least two of the three following criteria: a) balance sheet total: 20 000 000 EUR; b) net turnover: 40 000 000 EUR; c) average number of employees during the financial year: 250 (Directive 2013/34 / EC, Article 3, paragraph 3).

³ Large companies according to the Accountancy Act are companies which at 31 December of the current reporting period exceed at least two of the following criteria: 1. The book value of assets - 38 000 000 levs.; 2. NSR - 76 000 000 lev.; 3. The average number of employees during the period - 250 people.

⁴ The legislative provisions on the content and publication requirements of "non-financial declaration" apply in an equivalent aspect to "Consolidated non-financial statement" (AA, 2015, art. 52). Object of study in this paper is only the non-financial statement but conclusions and recommendations can be interpreted for the purposes of the consolidated non-financial statement.

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According to Federation of European Accountants the number of public interest entities in Bulgaria is around 900 (Definition of Public interest entities in Europe, 2014, p.7). Currently however there is no specific data on the number of large public-interest entities operating in our country. Specialized literature states that organizations obligated to develop and release non-financial statement will increase in the near future (Szabó & Sørensen, 2015, p. 320), (Filipova-Slancheva, 2015, p.42).

The introduction of the legal requirements for preparing and publishing a non-financial statement, as a new element of accountability of Bulgarian public interest enterprises is accompanied by some not yet explained circumstances.

First problematic moment occurs when defining what public interest entities are. Specifying the scope of the organizations that must develop and release non-financial statement is also relevant because of the fact that currently there is no clear and universally accepted definition of the term "public interest entity".

Secondly, it should be noted that the Bulgarian Accountancy Act doesn't give guidelines about the specific indicators that should be disclosed by the non-financial statement. The lack of such information in the legislation can lead to different interpretations about the aim of the statement and the necessary data that public interest entities should collect and release. This reduces the degree of uniformity and comparability of data in the statement.

Thirdly, the new Bulgarian Accountancy Act requires large public interest entities to add in their activity report information and analysis related to ecology and their employees. Separately from this report they should prepare another report for the information required by the non-financial statement. This would increase the needed time and resources for preparation and disclosure of the documents. In addition, it can have a negative effect towards ignoring the role and importance of the declaration by its compilers.

The presence of the previously mentioned problematic aspects can lead to incorrectness of the information in the document as well as increasing the administrative burdens of the enterprises. This assumption can cause the preparation and disclosure of the non-financial statement to become "meaningless". By correctly identifying the

companies affected by the legislature and clarifying the specific requirements and indicators needed for development of the statement it would help the entities to collect and analyze the required disclosure data on time.

The main goal of that study is to be made a comparative analysis of the current applicable European and national regulations regarding the structure, content and disclosure of non-financial statement. Such analyses would help for clarifying the necessary disclosure components in the non-financial statement, which can lead to optimization of the process of collecting the needed data and preparing the statement.

To achieve the main aims of his development the author has the following research tasks:

- To identify which organizations fall within the scope of public-interest entities.
- To outline the main elements that should be included in the content in the non-financial statement.
- To analyze the European and national requirements for preparing and publishing the non-financial statement.

The main subject of research in the study are major public-interest entities and the main theme is non-financial statement.

Research thesis that the author advocates is that by clarifying the nature, structure, content and requirements for preparing and publishing the non-financial statement the process of initial and subsequent collection and analysis of data subject to disclosure is optimized.

The adopted research method is based on analysis introduced at EU and national legislation regulations and scientific work of specialists in the field.

1. Scope of enterprises of public interest

Currently there is no final definition of the term "public interest entity". The EU regulation lists the organizations that fall under the purview of this type of legal entities (Directive 2014/56 / EC, Article 1, par.2, i. E). In general terms these are:

- Companies governed by the law of a Member State whose transferable securities are approved for trading on a regulated market of any Member State.
- Credit institutions.
- Insurance businesses.



- Businesses that have large social significance because of the nature of their activity, their size or the number of employees.

The International Ethics Standards Board for Accountants (IESBA) is proposing a relatively broader definition. The definition in question includes entities registered on the stock market, and any organization designated by law or regulation as a public interest entity (Manual Code of Ethics for Professional Accountants, 2015, p. 126-127). In addition, organization of public interest is any organization from which a law or a regulation requires the audit to be carried out in accordance with the same independency requirements that apply to entities registered on the stock market.

In Bulgaria until 01.01.2016 the definition of "business operating in the public interest" existed in the text of the Independent Financial Audit Act (IFAA). As a business operating in the public interest IFAA defines public companies and issuers of securities in the country and as well as in other Member State of the EU and European Economic Area (IFAA, 2013 Additional provisions, paragraph 1, item .11). Enterprises operating in the public interest are also:

- Credit institutions;
- Insurance; reinsurance and pension insurance companies;
- Companies that produce, transport and sell electricity and heat;
- Companies that import, transfer, distribute and transit of natural gas.
- Companies that provide water supply, sewerage and telecommunications services;
- "Bulgarian State Railways" - EAD and its subsidiaries.

Currently in determining the companies operating in the public interest IFAA (IFAA, 2015 Additional provisions, paragraph 1, item 11) refers to the Accountancy Act, where are being regulated public-interest entities of such types (AA, 2015 Additional provisions, para. 1, p. 22):

1. Enterprises whose transferable securities are have trading permission on a regulated market in a Member - State of the Union;
2. Credit institutions;
3. Insurers and reinsurers;
4. Pension insurance companies and funds managed by them;
5. Investment firms which are large enterprises,

according to the requirements of the Accountancy Act;

6. Collective investment schemes and management companies under the Law on the activities of collective investment schemes and other collective investment businesses (LACISOCIB, 2015, article 4). Businesses that fall within the previously specified hypothesis should be large enterprises as required by the Accountancy Act.;

7. Financial institutions under the Law on Credit Institutions (LCI), which are large companies in the Accountancy Act. As a financial institution LCI determines an entity other than a credit institution whose core business is focused on the performance of one or more of the following services (CIA, 2015, article 3):

- a) making payment activities under the Law on Payment Services and Payment Systems (PSPS 2015, article 4).
 - b) issuing and administering other means of payment such as traveler's checks and letters of credit;
 - c) activities in financial leasing;
 - d) perform guarantee transactions;
 - e) trading for own account or on behalf of clients with foreign currency and precious metals. The scope of the foregoing does not include derivative financial instruments on foreign exchange and precious metals;
 - f) provide services and/or perform investment activities under the Markets in Financial Instruments Directive (FIMA, 2015, article 5, para. 2 and 3).
 - g) money broking;
 - h) acquisition of credit claims and other forms of financing, such as factoring and forfeiting;
 - i) activities of issuing electronic money;
 - j) services for the acquisition of holdings in a credit institution or other financial institution;
 - k) loaning with funds not raised through public attraction of deposits or other repayable amounts⁵.
8. "Holding Bulgarian State Railways" - EAD and its subsidiaries;
 9. "Railway Infrastructure" National Company;
 10. Commercial companies, specializing in manufacturing, transportation or sale of electricity

⁵ In addition to these activities the legislature also includes in the definition of "financial institution" financial holding company, a mixed action financial holding, a payment institution and management company.



and/or heat, which are large enterprises by the Accountancy Act;

11. Traders with main activity - import, transmission, distribution and/or transit of natural gas. Businesses meeting the previous requirement should be large enterprises within the meaning of the Accountancy Act;

12. Commercial companies whose primary business is to provide water and sewage services.

Based on previously discussed definitions that are introduced in national legislation four main conclusions can be made:

Firstly, companies offering telecommunications services are no longer public-interest entities according to the Accountancy Act.

Secondly, public interest entities are companies that are specializing in the manufacture, transportation or sale of electricity and/or heat; import, transmission, distribution and/or transit of natural gas, as well as providing water and sewage services only in cases where they qualify as large enterprises within the meaning of BAA.

Thirdly, it should be noted that as to the classification of our national legislature, public interest entities are not limited to those companies set out in Directive 2014/56 / EU. In this regard in the text of the Accountancy Act are further introduced enterprises on a national level that are recognized as organizations of public interest.

Fourthly, it can be concluded that the Accountancy Act as well as the IFAA perceive the introduced by Directive 2014/56 /EU approach to listing companies of public interest.

Undisputed is the fact that for the purposes of non-financial statement we should undertake the definition of public interest entities that is introduced in the new Accountancy Act. By joining Dimitar Zhelyazkov's opinion we think that a definition of a concept should set precise criteria about what organizations fall under its subject (Zhelyazkov, 2016, p.37). It means that only a list of enterprises should not be interpreted as a definition. A list of organizations could have additional meaning to the definition by specifying the scope of the entities but not to give the criteria for which they fall under this scope. In this sense, it is appropriate and useful a theoretical definition of public interest entities to be introduced in the Accountancy Act.

Such definition should specify what exactly is the public interest those businesses meet and satisfy. From an etymological point of view, the term "interest" is linked to getting to know an object, event or phenomenon that is important or useful for those interested. In this sense, it is not irrelevant whether the organization offers products and services in the political, financial, spiritual, educational or some other interest of the citizens. In relation to the precedent we suggest that "public interest entities" for the purposes of non-financial statement are registered in the capital markets entities that offer financial, credit and/or investment products and/or services to the public, as well as the organizations mentioned in the additional provisions the Accountancy Act that are important for citizens due to the nature of its business, size or number of employees.

2. Non-financial statement as a new element of accountability of public-interest entities

In general, non-financial statements can be seen as a documents where companies disclose not financial information on policies adopted and carried out by the organization's activities. In a narrower aspect by non-financial statement seeks disclosure of data relating to the development and economic stability of the enterprise in the field of environment, employees and social policy of the organization. Essentially disclosures cannot be correctly interpreted by the public only on the basis of value measures, thus there is a need of narrative presentation of relevant policies, events and deals. In this regard, proper preparation and disclosure of non-financial statement data is essential for the image of the enterprise in the eyes of its creditors, investors, customers and society as a whole.

The preparation of non-financial statement should be seen as a stage of the annual reporting period. In this aspect, the construction of the content of the declaration is directly dependent on both the current and the periodic accounting of the organizations. Determining the nature and elements of the document are of particular importance as the beginning of the period for drawing up the accounting policies of the companies and in preparing their annual financial statements. In order to correctly determine the nature of the non-financial statement it is appropriate and useful to be addressed key European and national regulations



concerning the production and publication.

Currently European legislation hasn't got clear guidelines on the structure and content of non-financial declaration. It's indicated that the declaration should include a description of policies, results and risks associated with the environment, employees and social affairs, respect for human rights and the fight against corruption and bribery (Directive 2014/95/EU, Preamble 6). Information disclosed in the non-financial statement should contain data on the processes of due diligence applied by the company in respect of supply chains and the organization's subcontractors. The aim of the announced in the declaration is to "identify, prevent and mitigate existing and potential adverse impacts" for the organization. The content of the non-financial data disclosed in the declaration Directive 2014/95/EU (Preamble 7) requires the information to present data on:

- The policies and activities of the enterprise in the field of environmental and social issues. In a particular aspect it should be pointed out information about the current and foreseeable impact of the enterprise on the environment, health, safety and protection of human rights and freedoms. In connection with that, major public interest entities should assess, classify, record, process, analyze and disclose data on the use of energy from renewable and/or non-renewable sources, greenhouse gas emissions, water consumption and air pollution.

- Actions adopted by organizations in order to ensure gender equality and the implementation of fundamental conventions of the International Labour Organisation.

- Data on the results of the actions taken according to the implemented organization's environmental and social policies, which are measured on the basis of key indicators for results of operations related to the specific business.

- Information about working conditions in the organizations, social dialogue, respect for the right to information and consultation of workers, and respect for trade union rights.

- Health and safety at work, dialogue with local communities and/or actions taken for the protection and development of these communities.

- In terms of human rights, fight against corruption and bribery, non-financial statement shall contain a description of actions taken to

prevent violations of human rights and/or tools available to combat corrupt practices.

- If there are conditions for part of the business relationships, products or services enterprises to cause adverse effects on the environment and social sphere, such information is subject to additional disclosure in the declaration.

Previously stated data should correctly be described in the non-financial statement, alongside with brief information on the business model of the company as well as the methods by which large public interest entities manage environmental and social risks (Directive 2014/95 / EC, article 1, item 1).

From Bulgarian legal framework standpoint Accountancy Act requires the "non-financial statement" to contain four basic elements (AA, 2015, art. 48, para 2).

First, the statement should describe the business model of the company. In a particular aspect, the data should show the purpose, strategy, organizational structure, infrastructure and product portfolio of the company. Within the scope of this element further data falls regarding the policies produced and applied by the company on its main and auxiliary activities.

Secondly, the legislature requires declarations to indicate information about the policies that the business has adopted and applied regarding environmental and social issues. It should describe the environmental and social activities conducted by the organization during the reporting period as well as the achieved results.

Thirdly, the entity shall disclose in the non-financial statement information on its main goals, risks and tasks that lie ahead in terms of environmental and social policies. The legislator also requires disclosure of such activities that could lead to adverse impacts on the environment, employees or other social issues.

In fourth place in the text of the declaration should be described the main indicators of the results of activities related to environmental and social issues.

Based on the foregoing it can be argued that both European and national legislation outlines only the basic framework of the content of the statement. In this way the legislation enables enterprises independently to identify the key indicators that must be disclosed in the document. Such



circumstance is "understandable" because of the fact that the scope of major public interest entities covers various types of organizations. However, the lack of a clear methodology on reporting the data in the non-financial statement reduces the added value of documents for internal and external users of the information. Because of that it is possible that the compilers of the document can "undervalue" the role and importance of the non-financial statement. It should be noted that the disclosure of non-financial information has been part of the accountability of many large enterprises in global and national level, such as Casio⁶, RWE⁷, Enel⁸, Danone⁹, TPP Bobov Dol EAD¹⁰, etc. Studies show¹¹ that non-financial data with environmental and social content is disclosed mainly as elements of financial statements of companies. It can be independently disclose in a separate report or as part of the annual activity report of enterprises. Environmental and social accountability and availability of good practices regarding disclosure of mandatory and/or voluntary non-financial information is a subject to analysis and interpretations of a number of specialists (see: Kyoseva, 2014) and professional organizations (see: Centre for strategy and evaluation services). Their main objective is to create an appropriate set of data which optimizes the published non-financial information. Such practices, methods and proposals are not an object for analyzes in this paper, so they will not be examined in detail

The importance of developing appropriate methodology regarding the report of non-financial information from enterprises¹² is considered by the European Commission, which in early 2016 carried a representative survey among Member States. The

study involved 346 respondents, of which only one organization was registered in Bulgaria. Based on analysis of the data published on the EU website the following conclusions and recommendations can be drawn:

1. From a consumers' of non-financial information perspective respondents share the opinion that data with no financial terms is essential mainly for shareholders and investors. Consequently, the non-financial data announced should have additional value mainly for external natural and legal entities of the accountable unit. For this purpose, the information must be reliable, neutral and comparable. In the greatest comparability of data is a fundamental factor in making sound economic decisions of users of the information. Comparability of non-financial data could be achieved with the introduction of uniform criteria and indicators for the organizations that disclose information of a non-financial nature. It is appropriate and useful clear and uniform criteria and indicators for large enterprises in the public interest in connection with the preparation and disclosure of non-financial statement to be introduced.

2. According to the people involved in the polled, non-disclosed data should be primarily directed at the entity's performance in terms of ecology, social issues, employees and any other information that has no financial nature. Next, the disclosed non-financial information should provide details on the organization's adopted policies regarding risks that have no financial nature. At the lowest level, respondents are interested in data provided by the companies on the development of the organizations and their positioning on the market. In connection with the foregoing, it can be argued that as users of non-financial information those polled are more interested in the results, rather than the activities made by the organizations.

3. Respondents find for appropriate and useful the introduction of KPIs (key performance indicators) as a part of the announced environmental and social data in the statement. In addition, polled entities and individuals share the common opinion that the European Commission should establish such a methodology for reporting non-financial information that is applicable both for companies covered by Directive 2014/95/EU and for all organizations that publish of non-financial

⁶ For more information see: <http://web.casio.com/csr/env/data/>, open on 08.10.2016.

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¹⁰ For more information see: <https://eea.government.bg/eea/main-site/bg/tr/r-kpkz/dokladi-10/BobdrR.pdf>, open on 08.10.2016

¹¹ For more information see: <https://home.kpmg.com/xx/en/home/insights/2015/11/kpmg-international-survey-of-corporate-responsibility-reporting-2015.html>, open on 08.10.2016.

¹² Study of the European Commission [Online] Available at: <https://ec.europa.eu/eusurvey/publication/non-financial-reporting-guidelines-2016?surveylanguage=en>. [Open 04.26.2016]. The conclusions are based on respondents' answers to the questions 3, 6, 8, 9 in the survey.



nature. The methodology should not restrict businesses in assessing what financial information to disclose and it should give them "freedom" for selecting the key performance indicators. The European Commission's guideline should complement the regulatory framework and should not be completely borrowed from it.

In order to fulfill the requirement of establishing a non-financial statement the legislature imposes on to the firms an obligation to include information and analysis on issues related to ecology and employees in their reports (AA, 2015, Article 49). Generally, in the annual activity report is indicated information of financial and non-financial nature, of the status, activities and the main risks and uncertainties related to ecology and employees of the company (AA, 2015, art. 39). It should be noted that the Accountancy Act provides for a separate report on non-financial information. Directive 2014/95 /EC gives a possibility for Member States to exempt firms from the obligation to prepare a non-financial statement. Essential requirement is that companies submit a separate report relating to the same financial year and be in uniform with the non-financial statement content (Directive 2014/95/EU, Preamble 6). According to the text of the Accountancy Act, however, enterprises have fulfilled the obligation to prepare non-financial statement in the cases when report is made separately for the information required for non-financial statement. In our opinion, the drafting of a report and a non-financial statement with the same content is essentially impractical. In this sense, for reporting purposes its appropriate companies to establish either a separate report required for non-financial statement statement or a non-financial statement. The final stage of the non-financial statement is the publication of the report for the information required for non-financial statement with the report on the activities of major public interest entities. In addition, the report should be publicly available until 30 June of the following year on the website of the enterprise, as it must be disclosed in the management report.

Conclusion

The preparation and publication of non-financial statement should be seen as a new point of information and accounting of major public interest entities. The main objective of the document is to

improve the environmental and social image of the entities based on the correctly and clearly presents of the data in the statement. The process of preparing the statement is associated not only with spending more resources for the preparation, publication and audit of the document, but with preparation of the required disclosure information. Pinpointing the content requirements for the non-financial statement at the beginning of the reporting period enables timely collection and processing of the information needed to be published.

The currently existing European and national legislation provides mainly general guidelines for the content of the non-financial statement. On this basis when preparing the statement it is appropriate enterprises to take into account some of the existing international, European and national manuals. For example such manuals are UN Global Compact, ISO 26000, OECD Guidelines for Multinational Enterprises and others. In this case, the use of multiple and diverse sources of information may cause those who draw up the statement to not devote sufficient time and resources for the collection, processing and analysis of data that needs to be disclosure.

Another negative impact on the preparation of the statement is the fact that Bulgarian Accountancy Act requires preparation of a separate report for the information required for non-financial statement. The report and the statement should be viewed independently of its compilers, which can lead to the spending of more time and resources for the preparation and disclosure of them. On this basis, we think it is appropriate to reconsider the necessity of writing a separate report for the information required for the non-financial statement. It should be noted that the Legislature has not set a requirement on the volume of disclosures in the statement. Non-financial statement whose contents do not exceed one page, however, should not be regarded as sufficient for making justified economic decisions by the users of the document. In addition, it is appropriate the selected disclosure of enterprise performance to remain unchanged in two consecutive reporting periods. In this case the information in the statement will be comparable and compatible.

In conclusion it is possible when preparing the statement to be determine that there is no data for some of the indicators that need to be reported in the



document. Such situation could be avoided if at the beginning of the reporting period public-interest entities make a substantive analysis for identifying the necessary disclosure data in the non-financial statement. Of course, such assumption is directly related to the internal company organization activities that involves the process of collecting and processing of non-financial information. However, the timely identification of the indicators that are appropriate to be disclosed in the statement will streamline the process of preparing the document by reducing preparation time data. Such circumstance essentially would help the accounting, administrative and managerial staff of the public-interest entities at the stage of preparing the annual accounting reports, when time is a limited resource.

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