

## DRAFT NASCO 11

# Accounting Policies, Changes in Accounting Estimates and Errors

### General Provisions

1. This standard has been prepared in accordance with article 6 of the Accounting Law of Azerbaijan Republic and is based on NASCO 12 - accounting Policies, Changes in Accounting Estimates and Errors
2. This standard should be used, taking into account the additional provisions contained in Rules of Bookkeeping and also in the Explanations and Recommendations on its Application.
3. In the case of conflict between previous legislation and this standard this standard will prevail.

### Objective

- 4 The objective of this NASCO is to set out the criteria to be used in selecting and changing accounting policies, together with the accounting treatment and disclosure of changes in accounting policies, changes in accounting estimates and corrections of errors. The
- 5 Disclosure requirements for accounting policies, except those for changes in accounting policies, are set out in NASCO 1 *Presentation of Financial Statements*.

### Scope

- 6 This NASCO will be applied in selecting and applying accounting policies, and accounting for changes in accounting policies, changes in accounting estimates and corrections of prior period errors.
- 7 The tax effects of corrections of prior period errors and of retrospective adjustments made when applying changes in accounting policies are accounted for and disclosed in accordance with NASCO 3 (Current Profits Tax) and NASCO 4 (Deferred Profits Tax).

### Definitions

- 8 The following terms are used in this NASCO with the meanings specified:  
**Accounting policies** are the specific principles, bases, conventions, rules and practices applied by an enterprise in preparing and presenting its financial statements.  
**A change in accounting estimate** is an adjustment of the carrying amount of an asset or a liability, or the amount of the periodic consumption of an asset, that results from the assessment of the present status of, and expected future benefits and obligations associated with, assets and liabilities. Changes in accounting estimates are not corrections of errors.

**Material** Omissions or misstatements of items are material if they could, individually or collectively, influence the economic decisions of users taken on the basis of the financial statements. Materiality depends on the size and nature of the omission or misstatement and is a judgment made in the circumstances and on the assumption that users have a reasonable knowledge of business and economic activities and accounting and a willingness to study the information with reasonable care. The size or nature of the item, or a combination of both, could be the determining factor.

**Prior period errors** are omissions from, and misstatements in the enterprise's financial statements for one or more prior periods arising from a failure to use, or misuse of, reliable information that:

- (a) was available when financial statements for those periods; and
- (b) could reasonably be expected to have been obtained and taken into account in the preparation and presentation of those financial statements.

Such errors include the effects of mathematical mistakes, mistakes in applying accounting policies, inadvertent omissions or misinterpretations of facts, and fraud.

**Retrospective application** is the application of a new accounting policy to transactions, other events and conditions as if that policy had always been applied.

**Retrospective restatement** is correcting the recognition, measurement and disclosure of amounts of elements of financial statements as if a prior period error had never occurred.

**Impracticable** Applying a requirement is impracticable when the enterprise cannot apply it after making every reasonable effort to do so. For a particular prior period, it is impracticable to apply a change in an accounting policy retrospectively or to make a retrospective restatement to correct an error if:

- (a) the effects of the retrospective application or retrospective restatement cannot be reliably assessed ;
- (b) the retrospective application or retrospective restatement requires assumptions about what the management's intentions would have been in that period; or
- (c) the retrospective application or retrospective restatement requires significant estimates of amounts and it is impossible to distinguish objectively information about those estimates that:
  - (i) provides evidence of circumstances that existed on the date(s) as at which those amounts are to be recognised, measured or disclosed; and
  - (ii) would have been available when the financial statements for that prior periodfrom other information.

**Prospective application** of a change in accounting policy and of recognising the effect of a change in an accounting estimate are:

- (a) applying the new accounting policy to transactions, other events and conditions occurring after the date as at which the policy is changed; and

- (b) recognising the effect of the change in the accounting estimate in the current and future periods affected by the change.

## Accounting policies

### Selection and application of accounting policies

- 9 When a particular NASCO specifically applies to a transaction, other event or condition, the accounting policy or policies applied to that item will be that contained in the relevant NASCO. Those policies need not be applied when the effect of applying them is immaterial. However, it will be wrong to make, or leave uncorrected, immaterial departures from NASCOs if the intention is to achieve a particular presentation of an enterprise's financial position, financial performance or cash flows.
- 10 If a NASCO does not exist that specifically applies to a transaction, other event or condition, then the management of an enterprise will use its judgement in developing and applying an accounting policy that results in information that is:
- (a) relevant to the economic decision-making needs of users; and
  - (b) reliable, in that the financial statements:
    - (i) represent faithfully the financial position, financial performance and cash flows of the entity;
    - (ii) reflect the economic substance of transactions, other events and conditions, and not merely the legal form;
    - (iii) are neutral, ie free from bias;
    - (iv) are prudent; and
    - (v) are complete in all material respects.
- 11 In making the judgement described in paragraph 10, management will refer to, and consider, the following sources in descending order:
- (a) the requirements and guidance in NASCOs dealing with similar and related issues; and
  - (b) the definitions, recognition criteria and measurement concepts for assets, liabilities, income and expenses in the *Conceptual Framework*.
- 12 In making the judgement described in paragraph 10, management may also consider the most recent pronouncements of other standard-setting bodies that use a similar conceptual framework to develop accounting standards (such as the IASB), other accounting literature and accepted industry practices.

### Consistency of accounting policies

- 13 An enterprise will select and apply its accounting policies consistently for similar transactions, other events and conditions, unless a NASCO specifically requires different policies to be applied to certain items or groups of items. If a NASCO requires the application of a particular policies to certain items or groups of items, then that accounting policy will be applied consistently to those items or groups of items.

### **Changes in accounting policies**

- 14 An enterprise will change an accounting policy only if the change:
- (a) is required by a NASCO; or
  - (b) results in the financial statements providing reliable and more relevant information about the effects of transactions, other events or conditions on the enterprise's financial position, financial performance or cash flows.
- 15 The following are not changes in accounting policies:
- (a) the application of an accounting policy for transactions, other events or conditions that differ in substance from current transactions, other events or conditions; and
  - (b) the application of a new accounting policy for transactions, other events or conditions that did not occur previously or were immaterial.
- 16 The initial application of a policy to revalue assets in accordance with NASCO 7 *Property, Plant and Equipment* or NASCO 12 *Intangible Assets* is a change in an accounting policy to be dealt with as a revaluation in accordance with NASCO 7 or NASCO 12.

### **Applying changes in accounting policies**

- 17 Subject to paragraph 19:
- (a) an enterprise will account for a change in accounting policy resulting from the initial application of a NASCO in accordance with the specific transitional provisions, if any, in that NASCO; and
  - (b) when an enterprise changes an accounting policy on initial application of a NASCO that does not include specific transitional provisions applying to that change, or changes an accounting policy voluntarily, it will apply the change retrospectively.
- 18 For the purpose of this NASCO, early application of a NASCO or an Interpretation is not a voluntary change in accounting policy.
- 19 If a NASCO does not exist that specifically applies to a transaction, other event or condition, management may apply an accounting policy from the most recent pronouncements of other standard-setting bodies that use a similar conceptual framework to develop accounting standards (such as the IASB). If, following an amendment of such a pronouncement, the enterprise chooses to change an accounting policy, that change is accounted for and disclosed as a voluntary change in accounting policy.

### ***Retrospective application***

- 20 Subject to paragraph 19, then a change in accounting policy is applied retrospectively in accordance with paragraph 12, the enterprise will adjust the opening balance of each affected component of equity for the earliest prior period presented and the other comparative amounts disclosed for each prior period presented as if the new accounting policy had always been applied.

### ***Limitations on retrospective application***

- 21 When retrospective application is required by paragraph 12, a change in accounting policy will be applied retrospectively except if it is impracticable to

- determine either the period-specific effects or the cumulative effect of the change.
- 22 When it is impracticable to determine the effects of changing an accounting policy on comparative information for one or more prior periods, the enterprise will apply the new accounting policy to the carrying amounts of assets and liabilities as at the beginning of the earliest period for which retrospective application is practicable, which may be the current period, and will make a similar adjustment to the opening balance of each affected element of equity for that period.
- 23 When it is impracticable to determine the cumulative effect, at the beginning of the current period, of applying a new accounting policy to all prior periods, the enterprise will adjust the comparative information to apply the new accounting policy prospectively from the earliest date practicable.
- 24 When an enterprise applies a new accounting policy retrospectively, it applies the new accounting policy to comparative information for prior periods as far back as is practicable. Retrospective application to a prior period is not practicable unless it is practicable to determine the cumulative effect on the amounts in both the opening and closing balance sheets for that period. The amount of the resulting adjustment relating to periods before those presented in the financial statements is made to the opening balance of each affected component of equity of the earliest prior period presented. Usually the adjustment is made to retained earnings. However, the adjustment may be made to another component of equity (for example, to comply with another NASCO). Any other information about prior periods, such as historical summaries of financial data, is also adjusted as far back as is practicable.
- 25 When it is impracticable for an enterprise to apply a new accounting policy retrospectively, because it cannot determine the cumulative effect of applying the policy to all prior periods, the enterprise will apply the new policy prospectively from the start of the earliest period practicable. It therefore disregards the portion of the cumulative adjustment to assets, liabilities and equity arising before that date. Changing an accounting policy is permitted even if it is impracticable to apply the policy prospectively for any prior period.

#### Disclosure

- 26 When the initial application of a NASCO has an effect on the current period or any prior period, or that it would have such an effect except that it is impracticable to determine the amount of the adjustment, or that it might have an effect on future periods, an enterprise must disclose:
- (a) the title of the NASCO;
  - (b) that the change in accounting policy is made in accordance with its transitional provisions;
  - (c) the nature of the change in accounting policy;
  - (d) a description of the transitional provisions;
  - (e) the transitional provisions that might have an effect on future periods;
  - (f) for the current period and each prior period presented, the amount of the adjustment for each financial statement line item affected;
  - (g) the amount of the adjustment relating to periods before those presented; and

- (h) if retrospective application required by paragraph 12 is impracticable for a particular prior period, or for periods before those presented, the circumstances that led to the existence of that condition and a description of how and from when the change in accounting policy has been applied.

Financial statements of subsequent periods need not repeat these disclosures.

- 27 When a voluntary change in accounting policy has an effect on the current period or any prior period, or would have an effect on that period except that it is impracticable to determine the amount of the adjustment, or might have an effect on future periods, an enterprise will disclose:

- (a) the nature of the change in accounting policy;
- (b) the reasons why applying the new accounting policy provides reliable and more relevant information;
- (c) for the current period and each prior period presented, the amount of the adjustment for each financial statement line item affected;
- (d) the amount of the adjustment relating to periods before those presented; and
- (e) if retrospective application is impracticable for a particular prior period, or for periods before those presented, the circumstances that led to the existence of that condition and a description of how and from when the change in accounting policy has been applied.

Financial statements of subsequent periods need not repeat these disclosures.

- 28 When an entity has not applied a new NASCO that has been issued but is not yet effective, the enterprise will disclose:

- (a) this fact; and
- (b) known or reasonably estimable information relevant to assessing the possible impact that application of the new NASCO will have on the enterprise's financial statements in the period of initial application.

- 29 In complying with paragraph 26 an enterprise must disclose, as far as is practicable:

- (a) the title of the new NASCO;
- (b) the nature of the impending change or changes in accounting policy;
- (c) the date by which application of the NASCO is required;
- (d) the date as at which it plans to apply the NASCO initially; and
- (e) either:
  - (i) a discussion of the impact that initial application of the NASCO is expected to have on the enterprise's financial statements; or
  - (ii) if that impact is not known or reasonably estimable, a statement to that effect.

## **Changes in Accounting Estimates**

- 30 As a result of the uncertainties inherent in business activities, many items in financial statements cannot be measured with precision but can only be

estimated. Estimation involves judgements based on the latest available, reliable information. For example, estimates may be required of:

- (a) bad debts;
- (b) inventory obsolescence;
- (c) the useful lives of, or expected pattern of consumption of the future economic benefits embodied in, depreciable assets; and
- (d) warranty obligations.

- 31 The use of reasonable estimates is an essential part of the preparation of financial statements and does not undermine their reliability.
- 32 An estimate may need revision if changes occur in the circumstances on which the estimate was based or as a result of new information or more experience. By its nature, the revision of an estimate does not relate to prior periods and is not the correction of an error.
- 33 A change in the measurement basis applied is a change in an accounting policy, and is not a change in an accounting estimate. When it is difficult to distinguish a change in an accounting policy from a change in an accounting estimate, the change is treated as a change in an accounting estimate.
- 34 The effect of a change in an accounting estimate, other than a change to which paragraph 31 applies, will be recognised prospectively by including it in profit or loss in:
- (a) the period of the change, if the change affects that period only; or
  - (b) the period of the change and future periods, if the change affects both.
- 35 To the extent that a change in an accounting estimate gives rise to changes in assets and liabilities, or relates to an item of equity, it will be recognised by adjusting the carrying amount of the related asset, liability or equity item in the period of the change.
- 36 Prospective recognition of the effect of a change in an accounting estimate means that the change is applied to transactions, other events and conditions from the date of the change in estimate. A change in an accounting estimate may affect only the current period's profit or loss, or the profit or loss of both the current period and future periods. For example, a change in the estimate of the amount of bad debts affects only the current period's profit or loss and therefore is recognised in the current period. However, a change in the estimated useful life of a depreciable asset affects depreciation expense for the current period and for each future period during the asset's remaining useful life. In both cases, the effect of the change relating to the current period is recognised as income or expense in the current period. The effect, if any, on future periods is recognised as income or expense in those future periods.

### **Disclosure**

- 37 An enterprise will disclose the nature and amount of a change in an accounting estimate that has an effect in the current period or is expected to have an effect in future periods, except when it is impracticable to estimate that effect.
- 38 If the amount of the effect in future periods is not disclosed because estimating it is impracticable, an enterprise shall disclose that fact.

## Errors

- 39 Errors can arise in respect of the recognition, measurement, presentation or disclosure of elements of financial statements. Financial statements that contain either material errors or immaterial errors made intentionally to achieve a particular presentation of an enterprise financial position, financial performance or cash flows do not comply with NASCOs. Potential current period errors discovered in that period are to be corrected before the financial statements are authorised for issue. However, material errors are sometimes not discovered until a subsequent period, and these prior period errors are corrected in the comparative information presented in the financial statements for that subsequent period (see paragraphs 42–47).
- 40 Subject to paragraph 43, an enterprise shall correct material prior period errors retrospectively in the first set of financial statements authorised for issue after their discovery by:
- (a) restating the comparative amounts for the prior period(s) presented in which the error occurred; or
  - (b) if the error occurred before the earliest prior period presented, restating the opening balances of assets, liabilities and equity for the earliest prior period presented.

### Limitations on retrospective restatement

- 41 A prior period error will be corrected by retrospective restatement except if it is impracticable to determine either the period-specific effects or the cumulative effect of the error.
- 42 When it is impracticable to determine the period-specific effects of an error on comparative information for one or more prior periods presented, the enterprise will restate the opening balances of assets, liabilities and equity for the earliest period for which retrospective restatement is practicable (which may be the current period).
- 43 When it is impracticable to establish the cumulative effect, at the beginning of the current period, of an error on all prior periods, the enterprise will restate the comparative information to correct the error prospectively from the earliest date practicable.
- 44 The correction of a prior period error is excluded from profit or loss for the period in which the error is discovered. Any information presented about prior periods, including any historical summaries of financial data, is restated as far back as is practicable.
- 45 When it is impracticable to determine the amount of an error (eg a mistake in applying an accounting policy) for all prior periods, the enterprise must estimate the comparative information prospectively from the earliest date practicable.
- 46 Corrections of errors are not the same as changes in accounting estimates. Accounting estimates by their nature are approximations that may need revision as additional information becomes known. For example, the gain or loss recognised on the outcome of a contingency is not the correction of an error.

### Disclosure of prior period errors

- 47 In applying paragraph 38, an enterprise will disclose the following:
- (a) the nature of the prior period error;
  - (b) the amount of the correction for each prior period presented for each financial statement line item affected;
  - (c) the amount of the correction at the beginning of the earliest prior period presented; and
  - (d) if retrospective restatement is impracticable for a particular prior period, the circumstances that led to the existence of that condition and a description of how and from when the error has been corrected.

Financial statements of subsequent periods need not repeat these disclosures.

### **Impracticality of retrospective application and retrospective restatement**

48 Sometimes it is impracticable to adjust comparative information for one or more prior periods to achieve comparability with the current period. For example, data may not have been collected in the prior period(s) in a way that allows either retrospective application of a new accounting policy or retrospective restatement to correct a prior period error, and it may be impracticable to recreate the information.

49 It is often necessary to make estimates in applying an accounting policy to elements of financial statements. Estimation is inherently subjective, and estimates may be developed after the balance sheet date. Developing estimates is potentially more difficult when retrospectively applying an accounting policy or making a retrospective restatement to correct a prior period error, because of the longer period of time that might have passed since the affected transaction, other event or condition occurred. However, the objective of estimates related to prior periods remains the same as for estimates made in the current period, namely, for the estimate to reflect the circumstances that existed when the transaction, other event or condition occurred.

50 Therefore, retrospectively applying a new accounting policy or correcting a prior period error requires distinguishing information that

- (a) provides evidence of circumstances that existed on the date when the transaction, other event or condition occurred, and
- (b) would have been available when the financial statements for that prior period were authorised for issue

from other information. For some types of estimates it is impracticable to distinguish these types of information. When retrospective application or retrospective restatement would require making a significant estimate for which it is impossible to distinguish these two types of information, it is impracticable to apply the new accounting policy or correct the prior period error retrospectively.

51 Hindsight should not be used when applying a new accounting policy to, or correcting amounts for, a prior period, either in making assumptions about what management's intentions would have been in a prior period or estimating the amounts recognised, measured or disclosed in a prior period. In addition, the fact that significant estimates are frequently required when

amending comparative information presented for prior periods does not prevent reliable adjustment or correction of the comparative information.

**Effective date**

The effective date of this standard is determined by an appropriate order of the Ministry of Finance of the Republic of Azerbaijan.

**Appendix 1 – Comparison of National Accounting Standard for Commercial Organisations No.11 Accounting Policies, Changes in Accounting Estimates and Errors with International Accounting Standard No. 8 Accounting Policies, Changes in Accounting Estimates and Errors**

The National Accounting Standard for Commercial Organizations (NASCO11) – Accounting Policies, Changes in Accounting Estimates and Errors is based on International Accounting Standard 8 (including amendments resulting from new and amended IFRSs issued up to 31 December 2005) Accounting Policies, Changes in Accounting Estimates and Errors.

In all material respects, there are no differences between NASCO 11 and IAS 8. All principles contained in IAS 8 are also incorporated in NASCO 11.