

## Exposure Draft of National Accounting Standard for Commercial Organisations (NASCO 6)

### INCOME

#### General Provisions

1. This standard has been prepared in accordance with Article 6 of the Accounting Law of Azerbaijan Republic and based on International Accounting Standard 18 – Revenue.
2. This standard should be implemented, taking into account additional provisions contained in Rules of Bookkeeping and also in Explanations and Recommendations on the Application of the National Accounting Standards.
3. In the case of conflict between previous legislation and this standard this standard will prevail.

#### Objective

4. The objective of this National Accounting Standard is to ensure that reporting entities recognise, measure and disclose income in the Income Statement in a consistent, reliable and transparent manner.

#### Definitions

5. The following terms are used in this standard with the meanings specified:

**Income** - an increase in economic benefits during the accounting period in the form of inflows or increase of assets or decreases in liabilities that result in increases in equity, other than those relating to contributions from equity participants. Income encompasses revenue, other incomes.

**Revenue** - realised income that arises in the course of the ordinary activities of an enterprise and is classified under a variety of different headings including sales, fees, interest, dividends, royalties and rent. If it is probable that income arising from ordinary activities will recur frequently then such income is deemed to be revenue.

**Other Income** – is increase that meets definition of income, which may or may not be arisen in the course of the ordinary activities of an enterprise during reporting period. Other income may be recognized either in Income Statement or Statement of Changes in Equity according to the National Accounting Standards.

**Extraordinary Income** – income that arises from events or transactions that are untypical of the reporting enterprise's ordinary activities and environment.

**Ordinary Activities** - the main activity or activities normally undertaken by an enterprise in pursuit of its business objectives.

**Fair value** - the amount for which an asset could be exchanged, or a liability settled, between knowledgeable, willing parties in an arm's length transaction.

### Scope

6. This standard should be applied in the case of presentation of all Income Statements as a part of annual general purpose financial statements, which are declared consistent with National Accounting Standards.
7. This standard applies to both the financial statements of an individual enterprise and to the consolidated financial statements for a group of enterprises.
8. This standard applies to all types of commercial enterprises, except Public Interest Entity and subjects of small entrepreneurship, that prepare financial statements in accordance with Article 10 of the Accounting Law of the Republic of Azerbaijan.
9. All items classified as revenue and other income under the current standard should be recognised in the Income Statement as defined by NASCO 1 - Presentation of Financial Statements, if no other Standard requires it.

This means income arising from the following transactions and events:

- (a) the sale of goods whether produced by the enterprise for the purpose of sale or goods, land or other property purchased for resale;
  - (b) the rendering of services except for those directly related to construction contracts;
  - (c) the use by others of enterprise assets yielding interest, royalties and dividends; and
  - (d) other income as defined in this standard and reported through the Income Statement.
10. The use by others of the enterprise's assets gives rise to income in the form of:
    - (a) interest - charges for the use of cash or cash equivalents or amounts due to the enterprise;
    - (b) royalties - charges for the use of long-term assets of the enterprise, for example, patents, trademarks, copyrights and computer software; and
    - (c) dividends - distributions of profits to holders of equity investments in proportion to their holdings of a particular class of capital.
  11. NASCO 2 on the Changes in Equity Statement defines those types of income that recorded in equity accounts
  12. This standard also excludes from its scope income arising from:
    - (a) lease agreements;
    - (b) dividends arising from investments which are accounted for under the equity method;
    - (c) insurance contracts of insurance enterprises;
    - (d) changes in the fair value of financial assets and financial liabilities or their disposal;
    - (e) changes in the value of other of current assets;
    - (f) initial recognition and from changes in the fair value of biological assets related to agricultural activity;
    - (g) initial recognition of agricultural products; and
    - (h) the extraction of mineral ores.

## Recognition

13. The primary issue in accounting for income is determining when to recognise it in the financial statements. Whether it is reflected in net profit or loss for the period or in equity, income is recognised when it is probable that future economic benefits will flow to the enterprise and these benefits can be measured reliably.  
This standard identifies the circumstances in which the criteria will be met in order for income to be recognised in the Income Statement.
14. Income as defined by this standard includes only the gross inflows of economic benefits received and receivable by the enterprise on its own account. Taxes and other compulsory dues collected on behalf of third parties are not economic benefits which flow to the enterprise and do not result in increases in equity. Therefore, they are excluded from income and not recognised in either the Income Statement or in equity.
15. Income is usually recognised from single transactions which are the subject of signed contracts between the contracting parties. However, in certain circumstances, it is necessary to apply the recognition criteria to the separately identifiable components of a single transaction in order to reflect the substance of the transaction (a process known as segmentation). For example, when the selling price of a product includes an identifiable amount for subsequent servicing, that amount is deferred and recognised as revenue over the period during which the service is performed. Conversely, the recognition criteria are applied to two or more transactions together when they are linked in such a way that the commercial effect cannot be understood without reference to the series of transactions as a whole.

## Measurement

16. Income should be measured at the fair value of the consideration received or receivable.
17. The amount of income arising on a transaction is usually determined by agreement between the enterprise and the buyer or user of the asset. It is measured at the fair value of the consideration received or receivable taking into account the amount of any trade discounts and volume rebates allowed by the enterprise.
18. When the inflow of cash or cash equivalents is deferred, the present value of the deferred consideration may be less than the nominal amount of cash received or receivable. For example, an enterprise may provide interest-free credit to the buyer or accept a note receivable bearing a below-market interest rate from the buyer as consideration for the sale of goods. When the arrangement effectively constitutes a financing transaction, the fair value of the consideration is determined by discounting all future receipts using an imputed rate of present value of consideration. When below-mentioned conditions are met, imputed rate of interest of present value of consideration might be more clearly defined:
  - (a) the prevailing rate for a similar instrument of an issuer with a similar credit rating; or
  - (b) a rate of interest that discounts the nominal amount of the instrument to the current cash sales price of the goods or services.

The difference between the present value and the nominal amount of the consideration is recognised as interest income.
19. When goods or services are exchanged for goods or services which are of a similar nature and value, the exchange is not regarded as a transaction which generates income.

20. When no cash or no cash equivalents are used in exchange operation, income is recognized in fair value of goods or services received. However, when fair value of goods or services received can not be measured reliably, the income is measured at the fair value of the goods or services given up. When cash or cash equivalents are used in exchange operation as part of consideration, income is measured in fair value of goods or services received that increased or decreased to amount of cash or cash equivalents received or paid relatively. However, when fair value of goods or services received can not be measured reliably, income is measured in fair value of goods or services given up that increased or decreased to amount of cash or cash equivalents received or paid relatively.

### **Sale of Goods**

21. Income from the sale of goods should be recognised when all the following conditions have been satisfied:
- (a) the enterprise has transferred to the buyer the significant risks and rewards of ownership of the goods;
  - (b) the enterprise retains neither continuing managerial involvement to the degree usually associated with ownership nor effective control over the goods sold;
  - (c) the amount of income can be measured reliably;
  - (d) it is probable that the economic benefits associated with the transaction will flow to the enterprise; and
  - (e) the costs incurred or to be incurred in respect of the transaction can be measured reliably.
22. The assessment of when an enterprise has transferred the significant risks and rewards of ownership to the buyer requires an examination of the circumstances of the transaction.  
In most cases, the transfer of the risks and rewards of ownership coincides with the transfer of the legal title or the passing of possession to the buyer. This is the case for most retail sales.  
In other cases, the transfer of risks and rewards of ownership occurs at a different time from the transfer of legal title or the passing of possession.
23. If the enterprise retains significant risks of ownership, the transaction is not a sale and income is not recognised. An enterprise may retain a significant risk of ownership in a number of ways. Examples of situations in which the enterprise may retain the significant risks and rewards of ownership are:
- (a) when the enterprise retains an obligation for unsatisfactory performance not covered by normal warranty provisions;
  - (b) when the receipt of the income from a particular sale is contingent on the derivation of income by the buyer from its sale of the goods;
  - (c) when the goods are shipped subject to installation and the installation is a significant part of the contract which has not yet been completed by the enterprise; and
  - (d) when the buyer has the right to rescind the purchase for a reason specified in the sales contract and the enterprise is uncertain about the probability of return.
24. If an enterprise retains only an insignificant risk of ownership, the transaction is a sale and income is recognised. For example, a seller may retain the legal title to the goods solely to protect the collectability of the amount due. In such a case, if the enterprise has transferred the significant risks and rewards of ownership, the transaction is a sale and income is recognised. Another example of an enterprise retaining only an insignificant risk of ownership may be a retail sale when a refund is offered if the customer is not satisfied. Income in such cases is recognised at the time of sale provided the seller can reliably estimate future returns and recognises a liability for returns based on previous experience and other relevant factors.

25. Income is recognised only when it is probable that the economic benefits associated with the transaction will flow to the enterprise. In some cases, this may not be probable until the consideration is received or until an uncertainty is removed. For example, it may be uncertain that a foreign governmental authority will grant permission to remit the consideration from a sale in a foreign country. When the permission is granted, the uncertainty is removed and income is recognised. However, when an uncertainty arises about the collectability of an amount already recognised as income, the uncollectable amount or the amount in respect of which recovery has ceased to be probable is recognised as an expense, rather than as an adjustment of the amount of income originally recognised.
26. Income and expenses that relate to the same transaction or other event are recognised simultaneously; this process is commonly referred to as the matching of revenue and expenses. Expenses, including warranties and other costs to be incurred after the shipment of the goods can normally be measured reliably when the other conditions for the recognition of revenue have been satisfied. However, income cannot be recognised when the expenses cannot be measured reliably; in such circumstances, any consideration already received for the sale of the goods is recognised as a liability.

### Rendering of Services

27. When the outcome of a transaction involving the rendering of services can be estimated reliably, income associated with the transaction should be recognised by reference to the stage of completion of the transaction at the balance sheet date. The outcome of a transaction can be estimated reliably when all the following conditions are satisfied:
- (a) the amount of income can be measured reliably;
  - (b) it is probable that the economic benefits associated with the transaction will flow to the enterprise;
  - (c) the stage of completion of the transaction at the balance sheet date can be measured reliably; and
  - (d) the costs incurred for the transaction and the costs to complete the transaction can be measured reliably.
28. The date on which the service activity is entered into and the date when the activity is completed falls into different accounting periods. Therefore, the primary issue in accounting for such contracts is the allocation of income to the accounting periods in which the work is performed. The recognition of income by reference to the stage of completion of a transaction is often referred to as the percentage of completion method. Under this method, income is recognised in the accounting periods in which the services are rendered. The recognition of income on this basis provides useful information on the extent of service activity and performance during a period.
29. Income is recognised only when it is probable that the economic benefits associated with the transaction will flow to the enterprise. However, when an uncertainty arises about the collectability of an amount that has already been recognised as income, the uncollectable amount, or the amount in respect of which recovery has ceased to be probable, is recognised as an expense, rather than as an adjustment of the amount of income originally recognised.
30. An enterprise is generally able to make reliable estimates after it has agreed to the following with the other parties to the transaction:
- (a) each party's enforceable rights regarding the service to be provided and received by the parties;
  - (b) the consideration to be exchanged; and
  - (c) the manner and terms of settlement.

It is also usually necessary for the enterprise to have an effective internal financial budgeting and reporting system. The enterprise reviews and, when necessary, revises the estimates of income as the service is performed. The need for such revisions does not necessarily indicate that the outcome of the transaction cannot be estimated reliably.

31. The stage of completion of a transaction may be determined by a variety of methods. An enterprise uses the method that measures reliably the services performed. Depending on the nature of the transaction, the methods may include:
- (a) surveys of work performed;
  - (b) services performed to date as a percentage of total services to be performed; or
  - (c) the proportion that costs incurred to date bear to the estimated total costs of the transaction. Only costs that reflect services performed to date are included in costs incurred to date. Only costs that reflect services performed or to be performed are included in the estimated total costs of the transaction.
- Progress payments and advances received from customers often do not reflect the services performed.
32. For practical purposes, when services are performed by an indeterminate number of acts over a specified period of time, income is recognised on a straight line-basis over the specified period unless there is evidence that some other method better represents the stage of completion
- When there is expected that rendering of services is done by number of activities depending on each other, and one of activities is much more significant than any others, the recognition of income is postponed until the significant activity is executed.
- In other cases, when all activities have the same nature, and they are not dependent, income is recognized at the time of completion of each activity separately.
33. When the outcome of the transaction involving the rendering of services cannot be estimated reliably, income should be recognised only to the extent of the expenses recognised that are recoverable.
34. During the early stages of a transaction, although that the outcome of the transaction cannot be estimated reliably, it may be probable that the enterprise will recover the transaction costs incurred. Therefore, income is recognised only to the extent of costs incurred that are expected to be recoverable. As the outcome of the transaction cannot be estimated reliably, no profit is recognised.
35. When the outcome of a transaction cannot be estimated reliably and it is not probable that the costs incurred will be recovered, income is not recognised and the costs incurred are recognised as an expense. When the uncertainties that prevented the outcome of the contract being estimated reliably no longer exist, income is recognised in accordance with paragraph 29 rather than in accordance with paragraph 35.

#### **Other Income Arising from Changes in the Value of Assets and Liabilities**

36. Other income occurred as result of changes in value or sale of non-current tangible and intangible assets is recognized according to the NAS 10 and NASCO 7.

37. Other income occurred as result of consequent increase of value of inventories revalued to their net realizable value in previous reporting periods is recognized as reduction in expenses of the current period.

This income is measured in amount of increase of their current carrying to their initial cost. However, if current net realizable value is less than initial cost of these inventories, income is measured in amount of increase of their current carrying amount to their current net realizable value. Any excess of current net realizable value of inventories from their initial cost is not recognized as income.

38. Other income occurred as result of reduction in estimates of bad debt during reporting period, is recognized as decrease of expenses of reporting period and measured as difference between new estimates of bad debts recorded as adjustment to the receivables in balance sheet and its current amount.

When previously written off receivables are subsequently paid by debtor, occurred other income is recognized as decrease in expenses of reporting period in amount expected to be received. In such circumstances, the probability of inflow of the future economic benefits to the enterprise is considered.

### **Interest, Royalties and Dividends**

39. Income arising from the use by others of enterprise assets yielding interest, royalties and dividends should be recognised on the bases set out in paragraph 40 when:

- (a) it is probable that the economic benefits associated with the transaction will flow to the enterprise; and
- (b) the amount of the income can be measured reliably.

40. Income should be recognised on the following bases:

- (a) interest should be recognised on a time proportion basis that takes into account the effective yield on the asset;
- (b) royalties should be recognised on an accrual basis in accordance with the substance of the relevant agreement; and
- (c) dividends should be recognised when the shareholder's right to receive payment is established.

41. Income arising from the use by others of enterprise assets yielding interest, dividends and royalties is recognized in gross amount including any withholding taxes.

42. The effective yield on an asset is the rate of interest required to discount the stream of future cash receipts expected over the life of the asset to discount to the initial carrying amount of the asset. Interest income includes the amount of amortisation of any discount, premium or other difference between the initial carrying amount of a debt security and its amount at maturity.

43. When unpaid interest has accrued before the acquisition of an interest-bearing investment, the subsequent receipt of interest is allocated between pre-acquisition and post-acquisition periods; only the post-acquisition portion is recognised as income. When dividends on equity securities are declared from pre-acquisition net income, those dividends are deducted from the cost of the securities. If it is difficult to make such an allocation except on an arbitrary basis, dividends are recognised as income unless they clearly represent a recovery of part of the cost of the equity securities.

44. Royalties are accrued in accordance with the terms of the relevant agreement and are usually recognised on that basis unless, having regard to the substance of the agreement, it is more appropriate to recognise income on some other systematic and rational basis.

### **Presentation**

45. Income from the sale of goods or services and the disposal of assets is shown less VAT, excise and other taxes, trade discounts granted and sales returns.
46. Items of income and expense should be offset when, and only when
- (a) another National Accounting Standard requires or permits it; or
  - (b) income, losses and related expenses arising from the same or similar transactions and events are not material;
47. The following classifications of income are presented in the Income Statement in accordance with NASCO 1 - Presentation of Financial Statements:
- (a) sales revenue is income from the sale of goods, services, royalties and other sources where the income is expected to recur frequently and the activities generating the income are considered to be integral to the enterprise's ordinary activities;
  - (b) other operating income – including income from the use by others of the enterprise's intangible assets where such income is not expected to recur frequently, net income on disposal of non-financial assets, foreign exchange gains relating to operating activities, and income from providing services to employees such as canteen, recreation facilities and similar benefits;
  - (c) finance gains – including interest from financial assets, foreign exchange gains relating to interest-bearing investments and dividend income. Dividend income is subdivided into:
    - i. dividends from subsidiary enterprises;
    - ii. dividends from associated enterprises;
  - (d) Share of profit of associates and joint ventures; and
  - (e) extraordinary income.
48. The revenue of a diversified enterprise should be aggregated in the Income Statement but a separate disclosure of the main sources of revenue is required in accordance with Paragraph 49(e).

### **Disclosure**

49. An enterprise should disclose:
- (a) the accounting policies adopted for the recognition of income including the methods adopted to determine the stage of completion of transactions involving the rendering of services;
  - (b) the amount of each significant category of income recognised during the period including that arising from:
    - i. the sale of goods;
    - ii. the rendering of services;
    - iii. interest;
    - iv. royalties;
    - v. dividends;

- (c) the amount of income arising from exchanges of goods or services included in each significant category of income;
- (d) the nature and amount of items of other income if their size, nature and incidence is relevant to explain the performance of the enterprise for the period;
- (e) the nature and size of each item of extraordinary income; and
- (f) the materially significant sources of revenue from principal operations of a diversified enterprise with the amounts and explanation for each shown separately.

### **Effective Date**

50. The accounting practices set out in this National Accounting Standard should be applied to financial statements relating to accounting periods on or after 31 December 2005.

### **Appendix 1 – Comparison with IAS 18 – Revenue**

The Exposure Draft on National Accounting Standard (NAS) 6 is drawn primarily from International Accounting Standards 18 - Revenue. The main differences between NAS 6 and IAS 18 are as follows:

1. Whereas IAS 18 considers revenue only, the current standard distinguishes between revenue, which is defined as the gross inflow of economic benefits arising from ordinary activities that are expected to recur frequently, and other income which is defined as income arising in the course of the ordinary activities of an enterprise, other than revenue, that is reported through the Income Statement;
2. NAS 6 incorporates the concept of other gains, not found in the body of IFRS, which is defined as increases in economic benefits that meet the definition of income but which are nevertheless excluded from the enterprise's Income Statement;
3. NAS 6 also includes other definitions that are absent from IAS 18 and IFRS generally (namely "realised" and "unrealised"), or which have been modified from IFRS definitions (namely "extraordinary income" and "ordinary activities");
4. In the interests of greater clarity the disclosure and presentation requirements of the current standard are more detailed than those prescribed by IAS 18.