

**Exposure Draft of National Accounting Standard for Commercial Organisations (NASCO 8)
INVENTORIES**

General Provisions

1. This standard has been prepared in accordance with Article 6 of Accounting Law of the Republic of Azerbaijan and based on International Accounting Standard 2 - Inventories.
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. This standard determines the methodology for the recognition and measurement of inventories and its disclosure in the financial reports.

SCOPE

5. This standard should be applied in the case of presentation of all financial statements which are declared consistent with National Accounting Standards for Commercial Organizations.
6. This standard applies to both the financial statements of an individual enterprise and to the consolidated financial statements for a group of enterprises.
7. This standard applies to all types of commercial enterprises that prepare financial statements in accordance with NASCO.
8. This standard should be applied in the case of all inventories except those excluded by paragraph 9 of this standard.
9. This standard does not apply to:
 - (a) Work in progress arising under long term and construction contracts, inclusive of contracts on rendering services, that are directly related to them;
 - (b) Financial instruments;
 - (c) Biological assets related to agricultural activity and agricultural products at the point of harvest.
10. This Standard does not apply to the measurement of inventories held by:
 - (a) producers of agricultural and forest products, agricultural products after harvest, and producers involved to the processing of agricultural products, as well as minerals and mineral products, to the extent that they are measured at net realisable value in accordance with well-established practices in those industries. When such inventories are measured at net realisable value, changes in that value are recognised

- (b) Commodity broker-traders who measure their inventories at fair value less costs to sell. When such inventories are measured at fair value less costs to sell, changes in fair value less costs to sell are recognised in profit or loss in the period of the change.

Definitions

11. The terms used in this standard have the following meaning:

Inventories are considered as assets in following cases:

- (a) Held for sale or resale in the ordinary course of business;
- (b) In the process of production with the purpose of further sale of a product;
- (c) To be consumed in the production process, in performing work or rendering services, as well as in the general operation of an enterprise.

Net realisable value is the estimated selling price in the ordinary course of business less the estimated cost of completion and selling costs.

Fair value is the amount for which an asset could be exchanged, or a liability settled, between knowledgeable, willing parties in an arms length transaction.

Recognition

Initial Recognition

12. Inventory is recognized as an asset if it is probable that an enterprise will obtain future economic benefits, related to its use, and that its value can be measured reliably.
13. For accounting purposes inventories comprise:
- (a) Raw materials, direct and indirect materials, components and other material valuables, to be used for the production of goods, performing work, rendering services and for administration needs;
 - (b) Work in progress in the form of semi-processed and semi-assembled parts, components, products and uncompleted technological processes. Work-in-progress at enterprises, which performs services, comprises the expenses relating to the services, for which income is not yet recognized;
 - (c) Finished goods, which are produced at an enterprise with the purpose of sale;
 - (d) Goods in form of material valuables that were acquired and are held by an enterprise with the aim of further sale.
14. An accounting unit for inventory is a specific product or a homogeneous group or class of similar products. Acquired or produced inventory is recorded in the balance sheet of an enterprise at the initial value.

Recognition as an Expense

15. When inventories are sold the carrying value should be recognized as an expense in the accounting period in which the sale took place. This is the application of the fundamental principle of matching.
16. When the initial cost of inventories is written down to its net realizable value then the amount of this reduction in value and amount of loss of inventories should be recognized as an expense in the period in which the write down or loss occurs.
17. Amount of any reversal of value of inventories emerged from increase of net realizable value of inventories is recognized as decrease in amount that was considered as an expense in period when reversal occurs.

The reversal of previous write-downs cannot exceed the value of the cumulative total of previous reductions in the value of those inventories

18. When inventories are used for production or development of other assets, for example used in the construction of property, plant or equipment for use by the enterprise, then its cost will be included into carrying amount of these assets.

Recognition at the Balance Sheet Date

19. Inventories are to be recognized on the Balance Sheet as a current asset when it meets the definition of a current asset as set out in NASCO 1 – Presentation of Financial Statements.

Measurement

20. Inventories should be measured at the lower of cost and net realizable value.

Initial Measurement

21. Inventory is recorded at net realizable value if, at the balance sheet date:
 - (a) its estimated net realizable value, less costs required to complete the production and sale, has declined below the existing carrying value;
 - (b) it has become spoiled;
 - (c) it has become obsolete; or
 - (d) in any other way it has lost any of its previously expected economic benefit.

22. The initial value of inventory, acquired for payment, is the cost of inventory, which comprises the following actual costs:
- a. The amount, paid to a supplier in line with a contractual agreement;
 - (b) The amount, paid for informational, intermediary and other similar services, related to search and purchase of inventory;
 - (c) Amounts of import duties;
 - (d) Amounts of indirect taxes related to purchase of inventory, that are not subsequently recoverable by the enterprise;
 - (e) Expenses on procurement, transportation and handling, inclusive of insurance expenses and interest on commercial loans from suppliers;
 - (f) Other expenses, directly related to purchase of inventory and bringing it to a condition, in which it will be ready for intended use. Such expenses will include direct material expenses, direct labour expenses, and other direct expenses of an enterprise on processing and improvement of qualitatively technical characteristics of inventory.
23. The initial value of inventory, which is contributed to the statutory fund of an enterprise is its fair value. When the fair value of the inventory received cannot be measured reliably it is measured at the carrying value of the relevant capital contribution.
24. The initial value of inventory, obtained by an enterprise free of charge will be the fair value of that inventory.
25. The initial value of a unit of inventory, acquired in exchange for similar inventory, equals the carrying amount of inventory transferred. If the carrying amount of inventory transferred exceeds the fair value of the inventory received, the initial value of inventory received will be its fair value. The difference between the carrying amount of inventory transferred and fair value of inventory received is included into composition of expenses of the reporting period.
26. The initial value of inventory, acquired in exchange (or partial exchange) for dissimilar inventory, is the fair value of the inventory received. When the fair value of the inventory received cannot be measured reliably, it is measured at the fair value of the inventory transferred.
27. When the fair value of both received and given up inventories can not be measured reliably, the value of received inventories is estimated in carrying amount of given up inventories that increased or decreased to amount of cash or cash equivalents received or paid relatively.
28. The following expenses are not to be included into the initial value of inventory, but are to be expensed in the period in which they were incurred:
- (a) Above normal losses and shortages of inventory;
 - (b) Interest on loans used to finance the purchase of the inventory;
 - (c) General and other similar expenses that are not directly related to purchase and to bringing inventory to their location and condition, in which they are ready for intended use.
29. If an enterprise purchases inventories on deferred settlement terms and when the arrangement effectively contains a financing element, that element (for example a difference between the purchase price for normal credit terms and the amount paid) is recognised as interest expense over the period of the financing.

Measurement of Costs of Conversion

30. When inventory is transferred to production it may be measured under one of the following methods:
 - (a) Actual cost on the first in first out principle;
 - (b) Weighted average cost;
 - (c) Standard cost.
31. For all units of inventory of similar purpose and terms of use, only one of the above methods is to be used.
32. Inventory, which is transferred and services, which are rendered for specific orders and projects, as well as inventory, which is not interchangeable, is measured at identified cost.
33. The FIFO formula measurement assumes that inventory is used in production in the same sequence as it is received by an enterprise. At the end of reporting period the balance of inventory is made up of the cost of the most recently received items of inventory.
34. Weighted average cost formula measurement is applied for each unit of inventory by the way of dividing the total value of balances of such inventory at the beginning of reporting period and value of inventory, received during reporting period, by the total of inventory at the beginning of the reporting period and those, received in the reporting period.
35. Measurement at standard cost is based on norms of expenses per unit of production (or work or services), established by an enterprise taking into account normal levels of inventory, labor, capacity utilization and current prices. If an enterprise uses a system of standard costing, to ensure there are no material differences with actual costs and standard costs, actual costs are to be regularly checked and the standard costs adjusted if required.
36. The allocation of fixed production overheads to work in progress will be based on the normal production capacity of the enterprise. The amount of fixed overhead allocated to each unit of production is not increased in the case of low production levels but is to be expensed in the period in which it has been incurred. However, in periods of high production levels the amount of fixed overhead allocated to each unit of production must be decreased so as to avoid over-valuing inventory.
37. Variable production overheads are to be allocated to each unit of production based on the actual number of units produced.

Measurement of Net Realisable Value

38. The cost of inventories may not be recoverable if those inventories are damaged, if they have become wholly or partially obsolete, or if their selling prices have declined. The cost of inventories may also not be recoverable if the estimated costs of completion or the estimated costs to be incurred to make the sale have increased.

In these cases, the inventories are written down from its initial cost to net realisable value.

39. Inventories are usually written down to net realisable value item by item. In some circumstances, however, it may be appropriate to group similar or related items. This may be the case with items of inventory relating to the same product line that have similar purposes or end uses, are produced and marketed in the same geographical area, and cannot be practicably evaluated separately from other items in that product line. It is not appropriate to write inventories down on the basis of a classification of inventory, for example, finished goods, or all the inventories in a particular industry or geographical segment. Service providers generally accumulate costs in respect of each service for which a separate selling price is charged. Therefore, each such service is treated as a separate item.
40. Estimates of net realisable value are based on the most reliable evidence available at the time the estimates are made of the amount the inventories are expected to realise. These estimates take into consideration fluctuations of price or cost directly relating to events occurring after the end of the period to the extent that such events confirm conditions existing at the end of the period.
41. Estimates of net realisable value also take into consideration the purpose for which the inventory is held. For example, the net realisable value of the quantity of inventory held to satisfy firm sales or service contracts is based on the contract price. If quantity of inventories under the sales contracts is less than the inventory quantities held currently, the net realisable value of the excess is based on general selling prices.
42. Materials and other supplies held for use in the production of inventories are not written down below its initial cost if the finished products in which they will be incorporated are expected to be sold at or above cost. However, when a decline in the price of materials indicates that the cost of the finished products exceeds net realisable value, the materials are written down to net realisable value. In such circumstances, the replacement cost of the materials is the best available measure of their net realisable value.
43. A new assessment is made of net realisable value in each subsequent period. When the circumstances that previously caused inventories to be written down from its initial cost to net realizable value no longer exist or when there is clear evidence of an increase in net realisable value because of changed economic circumstances, the value inventories is evaluated by increasing of its current carrying amount to the their initial cost. However, when current net realizable value of inventories is less than initial cost of these inventories, the value of inventories is evaluated by increasing of its current carrying amount to current net realizable value. Thus, reversed carrying amount of inventories should be measured at the lower of initial cost and current net realizable value. This occurs, for example, when an item of inventory that is carried at net realisable value, because its selling price has declined, is still on hand in a subsequent period and its selling price has increased.

Measurement of Expense in the Income Statement

44. When inventories are sold, the expense shall be measured as the carrying amount of those inventories.
45. The expenses recognized as result of any write down of inventories from its carrying amount to their net realisable value shall be measured as the difference between the carrying amount and current net realisable value of these inventories.
46. Any reversal of inventories, arising from an increase in their net realisable value, shall be measured at the amount of increasing from their current carrying amount to its original cost. However, if current net realizable value of these inventories is less than their initial cost, then reversal of inventories is measured at amount of increasing from current carrying amount to its current net realizable value.

The amount of reversal of value of inventories can not be excess the accumulated amount of previous write-downs.

Presentation and Disclosure

47. The notes to financial statements should disclose:
- (a) Methods of inventory measurement used to value inventory;
 - (b) Carrying value of inventory in the context of separate classification groups;
 - (c) Carrying value of inventory, recorded at fair value less costs to sell;
 - (d) Carrying value of inventory pledged as a security for a liability;
 - (e) The amount of any write-down of inventories recognised as an expense in the period.
 - (f) Amount of increase of inventory resulting from any reversal of any previous write down which is being recognised as income in the current period and the reasons for the reversal of the previous write down.
 - (g) The carrying value of inventory recognised as an expense during the current period.

Effective Date

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

Appendix 1 – Comparison with IAS 2 – Inventories

The Exposure Draft on National Accounting Standard NASCO 8 is drawn primarily from International Accounting Standards 2 - Inventories. The main differences between NASCO 8 and IAS 2 are as follows:

1. The General Provisions set out in paragraphs 1 to 3 are additional to IAS 2 and relate the standard to the Accounting Law of the Republic of Azerbaijan, the Rules of Bookkeeping and in Explanations and Recommendations on the Application of the National Accounting Standards;
2. The Objective and Scope, paragraphs 4 and 8 to 10 are consistent with IAS 2. Paragraphs 5 to 7 define the scope of the organisations required to apply the standard as set out in the Accounting Law of the Republic of Azerbaijan;
3. The definitions of inventories and net realizable value consistent with IAS 2 except that the definition of fair value has been included in this standard for the sake of clarity as it is referred to in paragraphs 22, 23,24, 25,26 and 49(c).