

IV. Accounting and Auditing Standards

This chapter describes the accounting and auditing standards that govern the preparation of external financial reports and the audit of those reports. It comprises seven sections as follows:

Part One: Accounting Standards

- 1 – Introduction—provides an introduction to the accounting standards that apply in Azerbaijan.
- 2 – Accounting Standard-Setting Responsibilities and Processes—describes accounting standard-setting responsibilities and processes.
- 3 – Azerbaijan Accounting Standards—describes Azerbaijan accounting standards and ongoing reform initiatives.
- 4 – Public Sector Accounting Standards—discusses the accounting standards that prevail in the public sector.
- 5 – Comparison with International Accounting Standards (IASs)—identifies differences between Azerbaijan accounting standards and IAS.

Part Two: Auditing Standards

- 6 – Azeri Auditing Standards—describes the legal status of Azerbaijan auditing standards and the process by which they are developed.
- 7 – Issue Synopsis: Accounting and Auditing Standards—summarizes the issues identified in this chapter.

Part One. Accounting Standards

1. Introduction

As related in chapter II, accounting in the FSU was designed to meet the needs of the statistical and tax authorities. It consisted of adhering to a prescribed chart of accounts that was subordinated to requirements of the central planning system and reflected the diminished scope of financial management in a centrally-planned economy. The primary function of accounting was to record factual data to assess plan accomplishments, rather than an enterprise's financial situation.

In common with most other countries transiting from the Soviet accounting system, Azerbaijan continues to emphasize uniform accounting

systems (UASs). UASs comprise sector-specific charts of accounts supported by detailed accounting rules and instructions.

In the 1990s, although the Azerbaijan Government focused on the conflict and on developing the oil and gas sector, accounting reform was accorded a low priority. Moreover, the MOF worked, and continues to work, within tight resource constraints (it has received no external technical assistance to date). Consequently, Azerbaijan's transition towards IAS-based accounting standards has generally been slower than other FSU countries.

2. Accounting Standard-Setting Responsibilities and Processes

The *Accounting Law 1995* and the *Banking Law 1996* assign accounting standard-setting responsibilities to the MOF and to the National Bank of Azerbaijan (NBA), respectively. Neither law explicitly refers to IAS. Furthermore, the Production Sharing Agreements (PSAs) exempt relevant foreign companies from following Azeri accounting standards; most of these companies use IAS.

Azerbaijan "Accounting Standards" (UASs) are developed by both the MOF and the NBA. Consultation is undertaken during the development process, through interdepartmental committees involving the Ministries of Economic Development (MOED) and Taxation (MOT). Other interested parties such as the Chamber of Auditors of Azerbaijan are also consulted. Once approved, the "standards" are registered with the Ministry of Justice in accordance with the *Law on Statutory Registration*. This final step can take many months.

3. Azerbaijan Accounting Standards

Articles 120–125 of the *Civil Code 2000* stipulate the structure of Azeri financial statements; this structure is generally inconsistent with IAS-based financial reporting.

In 1995, the MOF released updated accounting instructions and charts of account (UASs). During 2001, the MOF prepared revised UASs. The Cabinet of Ministers is currently considering the revised system, which is more consistent with IAS-based accounting. The MOF has also presented an *Accounting Reform Plan* to the Cabinet of Ministers for consideration (see Appendix 4, Appendix 5 and Appendix 6).

The *Accounting Reform Plan* reflects continuation of Soviet accounting arrangements, albeit in a manner that is more consistent with IASs. In particular, it emphasizes national accounting as a primary purpose of financial reporting. To this end, it proposes that the following UASs will be prepared during 2001–2005:

- Industrial sector (e.g., heavy industry, light industry, food industry).
- Agriculture (farmer enterprises and other agricultural fields).
- Budget organizations (education, culture, health and others).
- Extra-budgetary organizations and activities.
- Insurance organizations.
- Municipalities.
- Energy sector (e.g., water, oil, gas, electricity).
- Services (e.g., transport, communications, construction).
- Small and medium enterprises.
- Joint-stock organizations.
- Foreign individuals and organizations.
- Commerce.

In early 2000, the NBA developed and promulgated an IAS-based UAS for the banking sector. An NBA-published instructional book—*Accounting Plan for the Azerbaijan Banking System*—was released in 2001 to support the revised arrangements.¹⁸ Substantial implementation progress has been made, however much remains to be done. To this end, the World Bank is providing assistance in terms of training, advice and systems development.

The oil and gas sector is largely excluded from Azeri accounting requirements through provisions in PSAs.

4. Public Sector Accounting Standards

Azerbaijan uses sector-neutral accounting standards—with very few exceptions, accounting standards and procedures apply to both the public sector and the private sector, at the organization level. At the whole-of-government level, the International Monetary Fund (IMF) and the World Bank have supported, and continue to support, the development of cash-based budgeting and reporting, on the Government Finance Statistics (GFS) basis, in contrast to the previous practice of accrual budgeting and reporting.

¹⁸ National Bank of Azerbaijan (NBA). 2001. *Accounting Plan for the Azerbaijan Banking System*. Baku: NBA. 305 pages.

Box 1: Recommendations for the Accounting Reform in the CIS¹⁹

The Accounting Standards Committee of IRFAA Eurasia has issued guidance on IAS adoption, which is relevant to Azerbaijan circumstances, as it based on the experiences of other FSU countries. Recommendations include:

- Ensure legal support for the IAS transition process by rescinding those provisions of the regulatory acts that impede the IAS transition.
- The law should relieve entities that have adopted IAS, from submitting NAS-based financial statements. Nor should they be required to maintain dual-standards accounting records.
- Ensure that banks and other financial institutions, listed companies, their subsidiaries are required to make the transition to IAS.
- When a large state organization is offered for sale, IAS-based financial statements (preferably audited) should be prepared and included in information materials.
- An IAS transition program should be developed for enterprises that are required to be audited.
- Ensure that NASs meet the needs of small businesses and closed joint-stock companies.
- Ensure that small companies maintain accounting records in a simplified manner and prepare financial statements in accordance with the simplified version of IAS.
- Develop a system of computerized transformation entries for tax purposes, which must be used by enterprises that prepare IAS financial statements to record tax liabilities, with tax computations based on the IAS system. For small enterprises, develop a simplified system of translating financial accounting figures into performance indicators for tax purposes.
- Modify the methodologies applied by statistical authorities when collecting and analyzing enterprise financial statements so that they do not impede adoption of IASs.
- Modify national Charts of Account in accordance with IAS requirements. Do not require enterprises using IAS to apply National Charts of Account and ledger-maintenance procedures.
- Prepare and ensure the wide distribution of detailed manuals, case studies and explanations relating to the practical application of IAS.
- Ensure that there are sufficient financial resources for the reform implementation process, in particular:
 - Provide step-by-step recommendations on the transition to IAS.
 - Provide recommendations and training for enterprise employees regarding the practical application of IAS.
 - Make the necessary changes to regulatory acts of controlling authorities, whose requirements, at present, are based on NASs.

¹⁹ IRFAA Eurasia. 2001. *Recommendations for the Accounting Reform in CIS Countries*. p. 6.

5. Comparison with International Accounting Standards (IASs)

The MOF has translated IASs from Russian into Azeri. Accounting standards for the financial sector and the oil and gas sector are generally consistent with IAS.

Accounting requirements for other sectors differ substantially from IAS. These differences include: (i) financial statement formats—statements of cash flows and equity changes are not required, however, much of this information is provided elsewhere in the financial statements (in accordance with Article 31 of the *Accounting Law*); (ii) fixed asset revaluations—mandated indexing formulas are applied; (iii) contingent liabilities are not required to be disclosed; (iv) consolidation—no rules exist for the preparation of consolidated financial statements; and (v) accounting bases—although expenses must be recorded on the accrual accounting basis, revenues can be recorded on either the accruals or cash bases (where the cash basis is used, direct costs must be recorded on the cash basis in accordance with Articles 130–134 of the *Tax Code 2000*).²⁰

Part Two. Auditing Standards

6. Azeri Auditing Standards

The Chamber of Auditors of Azerbaijan promulgates auditing instructions in accordance with regulations issued under the *Auditing Services Law 1995*. These instructions are directly based on International Standards on Auditing (ISAs).

The promulgation process has the following stages:

- The Chamber of Auditors selects an ISA for consideration.
- Three external specialists are assigned to the ISA. One specialist translates the standard into Azeri, the other two review the translation and analyze the suitability of the standard for Azerbaijan.
- The standard is presented to the Board of the Chamber of Auditors of Azerbaijan for consideration. The Board identifies conflicts with Azeri laws and conditions. Where these are considered beneficial, the Board identifies consequential amendments to Azeri laws. Otherwise, the

²⁰ Partial Source: IRFAA Eurasia. 2000. *Comparison of Azerbaijan Accounting Rules with International Accounting Standards*.

conflicting provisions are removed from the standard. Once agreed, the standard is registered with the Ministry of Justice. As of December 2001, the Chamber of Auditors of Azerbaijan had reviewed, amended and promulgated 24 of the 36 ISAs (see Appendix 10).

7. Issue Synopsis: Accounting and Auditing Standards

Chapter IX—*Issues and Recommendations*—identifies and describes constraints and proposes corrective actions. These include the following issues regarding accounting and auditing standards:

- The Azerbaijan accounting standard-setting process differs from international practice; for instance, it is not prescribed in law. Moreover, standard-setting responsibilities are distributed among agencies.
- The draft, and as yet unapproved Accounting Reform Plan, reflects objectives that are largely inconsistent with accounting in a market economy—for instance, a primary purpose of financial accounting is considered to be the provision of information, in a standard format, that is needed to prepare consolidated country financial statements, which incorporate all entities, both private and public sector. The Plan also emphasizes the continued development of UASs.