

**NATIONAL ACCOUNTING STANDARD FOR  
COMMERCIAL ORGANISATIONS № 10**

**“PROVISIONS<sup>1</sup>, CONTINGENT LIABILITIES, AND  
CONTINGENT ASSETS”**

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<sup>1</sup> Translation into Russian and Azeri: ‘estimated liabilities’

## CONTENTS

GENERAL PROVISIONS .....	3
SCOPE .....	3
DEFINITIONS .....	4
RECOGNITION .....	5
MEASUREMENT .....	7
APPLICATION OF THE RECOGNITION AND MEASUREMENT .....	9
EFFECTIVE DATE .....	12
Appendix 1 – Comparison with IAS 37 Provisions, Contingent Liabilities and Contingent Assets .....	12

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# NATIONAL ACCOUNTING STANDARD FOR COMMERCIAL ORGANISATIONS № 10

## “PROVISIONS<sup>2</sup>, CONTINGENT LIABILITIES, AND CONTINGENT ASSETS”

### GENERAL PROVISIONS

#### Purpose of the Standard

1. This standard has been prepared in accordance with the Accounting Law of Azerbaijan Republic and is based on International Accounting Standard 37 Provisions, Contingent Liabilities, and Contingent Assets.

#### Objective

2. The objective of this Standard is to define the appropriate recognition criteria, measurement bases and disclosures in the financial statements that are to be applied in relation to provisions, contingent liabilities and contingent assets.

### SCOPE

3. This standard should be applied, taking into account the additional provisions contained in Rules of Bookkeeping and also in the Explanations and Recommendations on its Application to both the financial statements of commercial enterprises defined in the Article 10 of the Accounting Law of the Azerbaijan Republic and to the consolidated financial statements.
4. In the case of conflict between previous legislation and this Standard this Standard will prevail .
5. Enterprises applying this Standard at their election, may prepare their financial statements and consolidated financial statements in conformity with International Financial Reporting Standards
6. This Standard is to be applied in accounting for provisions, contingent liabilities and contingent assets, except:
  - (a) those resulting from executory contracts, except where the contract is onerous;
  - (b) insurance contracts.
7. Where another Standard deals with a specific type of provision, contingent liability or contingent asset, a subject of accounting is to apply that Standard instead of this Standard. For example, this Standard does not apply to the followings:
  - (a) construction contracts (see NASCO 16 Construction Contracts);
  - (b) income taxes (see NASCO 3 Current Taxation);

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<sup>2</sup> Translation into Russian and Azeri: ‘estimated liabilities’

- (c) leases (see NASCO 14 Leases);
  - (d) employee benefits (see NASCO 29 Employee Benefits);
8. If a provision is related to the recognition of revenue, this Standard does not address the recognition of revenue in such cases but is relevant only to the provision created.
9. Other Standards specify whether expenditures are treated as assets or as expenses. These issues are not addressed in this Standard. Accordingly, this Standard neither prohibits nor requires capitalisation of the costs recognised when a provision is made.

## DEFINITIONS

10. The following terms are used in this Standard with the meanings specified:

**A provision** is a liability of uncertain timing or amount.

**An obligating event** is an event that creates a legal or constructive obligation that results in a subject of accounting having no realistic alternative to settling that obligation.

**A legal obligation** is an obligation that derives from:

- (a) the explicit and implicit terms of a contract;
- (b) legislation; or
- (c) other operation of law.

**A constructive obligation** is an obligation that derives from a subject of accounting's where:

- (a) by an established pattern of past practice, published policies or a sufficiently specific current statement, the subject of accounting has indicated to other parties that it will accept certain responsibilities; and
- (b) as a result, the subject of accounting has created a valid expectation on the part of those other parties that it will discharge those responsibilities.

**Probable** means that something is more likely than not to occur or exist.

**Possible** means that something may but more likely will not occur or exist.

**Remote** means something most likely will not occur or exist.

**Definitely determinable liability** is a liability of certain timing and amount.

**A contingent liability** is:

- (a) a possible obligation that arises from past events and whose existence will be confirmed only by the occurrence or non-occurrence of one or more uncertain future events not wholly within the control of the subject of accounting; or
- (b) a present obligation that arises from past events but is not recognised because:
  - (i) it is not probable that an outflow of resources embodying economic benefits will be required to settle the obligation; or
  - (ii) the amount of the obligation cannot be measured with sufficient reliability.

**A contingent asset** is a possible asset that arises from past events and whose existence will be confirmed only by the occurrence or non-occurrence of one or more uncertain future events not wholly within the control of the subject of accounting.

**An onerous contract** is a contract in which the unavoidable costs of meeting the obligations under the contract exceed the economic benefits expected to be received under it.

**A restructuring** is a programme that is planned and controlled by management, and materially changes either:

- (a) the scope of a business undertaken by a subject of accounting; or
- (b) the manner in which that business is conducted.

## Provisions and other Liabilities

11. Provisions can be distinguished from other liabilities such as trade payables and accruals because there is uncertainty about the timing or amount of the future expenditure required in settlement

Accruals are often reported as part of trade and other payables, whereas provisions are reported separately.

## Provisions and Contingent Liabilities

12. Within this Standard provisions and contingent liabilities can be differentiated as follows:
- (a) provisions - are to be recognised as liabilities since they are present obligations that can be measured reliably and it is probable, i.e. more likely than not, that an outflow of economic resources will be required to settle the obligations; and
  - (b) contingent liabilities - are not to be disclosed as liabilities because they are either:
    - (i) possible obligations, as it has yet to be confirmed whether the subject of accounting has a present obligation that could lead to an outflow of economic resources; or
    - (ii) present obligations that do not meet the recognition criteria in this Standard.

## RECOGNITION

### Provisions

13. A provision shall be recognised when:
- (a) a present obligation as a result of a past event exists;
  - (b) it is probable that an outflow of economic resources will be required to settle the obligation; and

- (c) a reliable estimate can be made of the amount of the obligation.

If these conditions are not met, no provision shall be recognised.

## Present Obligations

- 14. If it is not clear that a present obligation exists then all available evidence should be considered including, for example, the opinion of experts. On the basis of such evidence:
  - (a) where it is more likely than not that a present obligation exists at the balance sheet date, the subject of accounting will recognise a provision providing that all other recognition criteria have been satisfied; or
  - (b) where it is more likely that a present obligation does not exist at the balance sheet date, the subject of accounting will disclose a contingent liability, unless the possibility of an outflow of economic resources is remote, or
  - (c) if there exists a contingent liability but the possibility of an outflow of economic resources is remote then no disclosure need be made.

## Past Event

- 15. A past event that leads to a present obligation is called an obligating event. For an event to be an obligating event, the subject of accounting will have to discharge the obligation created by the event. This occurs when:
  - (a) the settlement of the obligation can be enforced by law; or
  - (b) in the case of a constructive obligation, where the event creates valid expectations in other parties that the subject of accounting will discharge the obligation
- 16. No provision is to be recognised for costs that have to be incurred to permit a subject of accounting to operate in the future. The only liabilities to be recognised in a subject of accounting's balance sheet are those that exist at the balance sheet date arising from past events.
- 17. A management or board decision on its own will not give rise to a constructive obligation at the balance sheet date. For a management or board decision to give rise to a constructive obligation the decision must have been communicated before the balance sheet date to those affected by it in such a way as to raise a valid expectation in them that the subject of accounting will implement that decision.
- 18. If an event does not yet give rise to an obligation but may do so at a later date because of proposed changes in the law, a legal obligation will only arise when the proposed legislation is virtually certain to be enacted.

## Probable Outflow of Economic Resources

- 19. Recognition of a liability requires not only a present obligation but also the probability of an outflow of economic resources necessary to settle that obligation. An outflow of economic resources is regarded as probable if the probability that the event will occur is greater than the probability that it will not. Where it is not probable that a present obligation exists, a subject of accounting must disclose the event as a contingent liability, unless the possibility of an outflow of economic resources is remote in which case no disclosure is required.

20. Where a number of similar obligations exist at the same time, the probability that an outflow will be required in settlement is determined by considering the class of similar obligations as a whole. If it is probable that an outflow of economic resources will be needed to settle the class of obligations as a whole, a provision is recognised.

### **Reliable Estimate of the Obligation**

21. A subject of accounting will make an estimate of the obligation that is sufficiently reliable to use in recognising a provision. Where no reliable estimate can be made, a liability cannot be recognized in the balance sheet. That liability is to be disclosed as a contingent liability

### **Contingent Liabilities**

22. Contingent liabilities are not to be recognised in the financial statements but are to be disclosed in the Notes to Financial Statements unless the possibility of an outflow of economic resources is remote in which case no disclosure need be made.
23. Where a subject of accounting is liable for an obligation together with others, the part of the obligation that is expected to be met by others is to be treated as a contingent liability. The part that is to be met by the subject of accounting is to be recognised as a provision provided that it meets the criteria that define a provision.
24. Contingent liabilities are to be assessed regularly, at least at the end of each accounting period, to determine whether an outflow of economic resources has become probable. If the expected outflow of economic resources does become probable, a provision is to be recognised in the financial statements of the period in which the change in probability occurs except in circumstances where no reliable estimate can be made.

### **Contingent Assets**

25. Contingent assets are not to be recognized in the balance sheet. When the probability of inflow of economic resources becomes virtually certain, then the related asset is not a contingent asset and its recognition is appropriate.
26. A contingent asset is disclosed where an inflow of economic benefits from the contingent asset is probable. If the probability of expected inflow of economic benefits is remote then no disclosure need be made.
27. Contingent assets are to be assessed regularly, at least at the end of each accounting period, to determine whether an inflow of economic benefits has become, or remains, probable. If the expected inflow of economic benefits does become, or remains, probable, disclosure is to be made.

## **MEASUREMENT**

### **Best Estimate**

28. The amount recognised as a provision is to be the best estimate of the expenditure required to settle the present obligation at the balance sheet date.

29. The best estimate of the expenditure required to settle the present obligation is the amount that a subject of accounting would normally expect to pay to settle the obligation at the balance sheet date or to transfer it to a third party at that time.
30. Where the provision being measured involves a number of items, the obligation is to be estimated by weighting all possible outcomes by their associated probabilities thus arriving at the provision's "expected value". Where there is a continuous range of possible outcomes, and each point in that range is as likely as any other, the mid-point of the range is to be used.
31. Where a single obligation is being measured, the individual most likely outcome may be the best estimate of the liability. However, the subject of accounting must consider all other possible outcomes. Where other possible outcomes are either mostly higher or mostly lower than the most likely outcome, the best estimate will be a higher or lower amount.
32. The provision is to be measured before any taxation considerations, as the tax consequences of the provision, and changes in it, are dealt with under NASCO 3 Current Income Tax.

### **Risks and Uncertainties**

33. Uncertainties are to be taken into account in reaching the best estimate of a provision. However, income or assets must not be overstated and expenses or liabilities must not be understated. Uncertainty does not justify the creation of excessive provisions or a deliberate overstatement of liabilities.
34. Disclosure of the uncertainties surrounding the amount of the expected expenditure is to be made.

### **Present Value**

35. Where the effect of the time value of money is material, the amount of a provision will be the present value of the expenditures expected to be required to settle the obligation. The discount rate will be a pre-tax rate that reflects current market assessments of the time value of money.

### **Future Events**

36. Expected future events that may affect the amount required to discharge an obligation are to be reflected in the amount of the provision when there is sufficient objective evidence that these future events will occur.
37. The effect of possible new legislation is to be taken into consideration in measuring an existing obligation when sufficient objective evidence exists that the legislation is virtually certain to be enacted. Before possible new legislation can be taken into consideration there must be sufficient objective evidence of both what any new legislation will demand and of whether it is virtually certain to be enacted and implemented. If sufficient objective evidence does not exist or will not exist until the new legislation is actually enacted then it cannot be presumed and cannot be taken into consideration when determining the extent of the obligation.

## **Expected Disposal of Assets**

38. Gains on the expected disposal of assets are not to be taken into account in measuring a provision, even if the expected disposal is closely linked to the event that gives rise to the provision.

Instead, a subject of accounting is to recognise such gains at the time specified by the Standard dealing with the assets concerned.

## **Reimbursements**

39. If some or all of the expenditure required to settle a provision is expected to be reimbursed by another party, the reimbursement will only be recognised when it is virtually certain that reimbursement will be received if the subject of accounting discharges the obligation. The reimbursement is to be treated as a separate asset and is not to exceed the amount of the provision.
40. When the provision is discharged, the expense relating to the provision is to be stated in the income statement net of the amount recognised for reimbursement.
41. When the subject of accounting is not to be held liable for the possible future costs to be reimbursed by the third party if the latter fails to pay the reimbursement then the subject of accounting has no liability for these costs and no provision for them is to be made

## **Changes in Provisions**

42. Provisions have to be reviewed at each balance sheet date and adjusted to reflect the current best estimate. If the circumstances that originally gave rise to the creation of the provision have altered such that the provision no longer satisfies the recognition criteria for a provision then the existing provision is to be reversed.
43. Where discounting is used, the carrying amount of a provision increases in each period to reflect the passage of time. This increase is to be recognised as a borrowing cost.

## **Use of Provisions**

44. A provision is only to be used for expenditures for which the provision was originally recognized.

## **APPLICATION OF THE RECOGNITION AND MEASUREMENT**

### **Rules Future Losses**

45. No provision is to be recognised for expected future losses that will arise from future activities.
46. An expectation of future operating losses is an indication that certain assets of the operation may be impaired. An entity tests these assets for impairment under NASCO 24 Impairment of Assets.

## Onerous Contracts

47. If a subject of accounting has a contract that is onerous, the present obligation under the contract is to be recognised and measured as a provision.

Contracts described in paragraph 8(b) that are not onerous fall outside the scope of this Standard.

48. Before a separate provision for an onerous contract is created, a subject of accounting will recognise any impairment loss that has occurred on assets dedicated to that contract<sup>3</sup>.

## Restructuring

49. A provision for restructuring costs is to be recognised only when the general recognition criteria for provisions are met. In addition, paragraphs 54-59 explain how the general recognition criteria are to be interpreted in their application to restructurings.

50. A constructive obligation to restructure will only arise when a subject of accounting:

- (a) has a detailed formal plan for the restructuring identifying at least:
- (i) the business or part of a business concerned;
  - (ii) the principal locations affected;
  - (iii) the location, function, and approximate number of employees who will be compensated for terminating their services;
  - (iv) the expenditures that will be undertaken to effect the restructuring ; and
  - (v) when the plan of restructuring will be implemented; and
- (b) Has raised an expectation in those affected by the restructuring that it will be carried out by either having started to implement that plan or by having announced its main features to those affected by it.

51. For a plan to be sufficient to give rise to a constructive obligation when communicated to those affected by it, its implementation needs to be planned to begin as soon as possible and to be completed in a timeframe that makes significant changes to the plan unlikely. If it is expected that there will be a long delay before the restructuring begins or that the restructuring will take an unreasonably long time then a constructive obligation cannot be assumed to exist.

52. A management or board decision to restructure taken before the balance sheet date will not result in a constructive obligation at the balance sheet date unless the subject of accounting has, before the balance sheet date:

- (a) started to implement the restructuring plan; or
- (b) announced the main features of the restructuring plan to those affected in such a way that they can reasonably expect that the subject of accounting will carry out the restructuring.

If a subject of accounting starts to implement a restructuring plan, or announces its main features to those affected after the balance sheet date but before publication of the financial statements, then if the restructuring is a material event it must be disclosed in the financial statements.

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<sup>3</sup> NASCO on Impairment of assets will be introduced at a later date

53. If a subject of accounting takes a decision to sell an operation and announces that decision publicly, no constructive obligation can exist until a purchaser has been identified and there is a binding sale agreement.
54. A restructuring provision will include only the direct expenditures expected to arise from the restructuring and which are both:
  - (a) a necessarily cost incurred by the restructuring; and
  - (b) not associated with the ongoing activities of the subject of accounting.
55. Future losses up to the date of a restructuring are not to be included in any provision that results from that restructuring. Similarly, any expected gains on disposal of assets are not taken into account in measuring a restructuring provision.

## Disclosure

56. For each class of provision, a subject of accounting will disclose in the Notes to the Financial Statements:
  - (a) the carrying amount at the beginning and end of the period;
  - (b) additional provisions made in the period, including increases to existing provisions;
  - (c) amounts incurred and charged against the provision during the period;
  - (d) unused amounts reversed during the period;
  - (e) the increase during the period in the discounted amount arising from the passage of time and the effect of any change in the discount rate;
  - (f) a brief description of the nature of the obligation and the expected timing of any resulting outflows of economic resources;
  - (g) an indication of the uncertainties about the amount or timing of those outflows and the major assumptions made concerning future events;
  - (h) the amount of any expected reimbursement, stating the amount of any asset that has been recognised for that expected reimbursement

Comparative financial information does not have to be disclosed

57. Unless the possibility of any outflow of economic resources in settlement is remote, a subject of accounting will disclose for each class of contingent liability at the balance sheet date a brief description of the nature of the contingent liability and, where practicable:
  - (a) an estimate of its financial effect, measured under paragraphs 28-38;
  - (b) an indication of the uncertainties relating to the amount or timing of any outflow of economic resources; and
  - (c) the possibility of any reimbursement.
58. A class of provisions or contingent liabilities may only be created if the nature of the items that make up the class is sufficiently similar for a single statement about them to be reasonable.

59. Where a provision and a contingent liability both arise from the same set of circumstances, the disclosure of both must be made in accordance with paragraph 56-57 so as to make clear the link between the provision and the contingent liability.
60. Where an inflow of economic benefits is probable, a subject of accounting will disclose in the Notes to the Financial Statements a brief description of the nature of the contingent assets at the balance sheet date, and, where practicable, an estimate of their financial effect.
61. Where any of the information required by paragraphs 57 and 60 of this Standard is not disclosed because it is not practicable to do so, that fact must be stated.
62. If disclosure of some or all of the information required by paragraphs 56-60 of this Standard can be expected to prejudice the position of the subject of accounting in a dispute with other parties on the subject matter of the provision, contingent liability or contingent asset, then such disclosures need not be made. The subject of accounting will, however, disclose the general nature of the dispute, the fact that the information has not been disclosed and reasons why disclosure has not been made.

### **First Time Application**

63. On the first time of application of this standard a subject of accounting may elect to measure the liabilities at the date of transition to NASCO using the amount recognized in accordance with accounting regulations of Azerbaijan Republic current at the time of transition to NASCO.

### **EFFECTIVE DATE**

64. This Standard becomes operative after decree of Ministry of Finance.

### **Appendix 1 – Comparison with IAS 37 Provisions, Contingent Liabilities and Contingent Assets**

This National Accounting Standard for Commercial Organisations (NASCO) 10 – Provisions, Contingent Liabilities and Contingent Assets is drawn primarily from International Accounting Standard (IAS) 37 (2006) – Provisions, Contingent Liabilities and Contingent Assets

The main differences between NASCO 10 and IAS 37 are as follows:

- The General Provisions set out in paragraph 1 is added to NASCO 10 and relates the standard to the Accounting Law of the Republic of Azerbaijan. IAS 37 does not contain such a section.
- Paragraphs 3 and 4 of NASCO 10 define the scope of the organisations required to apply the standard as set out in the Accounting Law of the Republic of Azerbaijan.
- Certain definitions are included in IAS 37 but have been excluded from NASCO 10 when such definitions are already included in earlier NASCOs. To include them again in this NASCO would be unnecessary repetition.
- NASCO 10 has additional definitions that are not present in IAS 37. These definitions are for the terms “probable”, “possible”, and “remote”. These terms are included in both

IAS 37 and NASCO 10 and definitions are included in NASCO 10 to assist in the understanding of the clauses in which they occur within the NASCO.

- Certain examples and explanations contained in IAS 37 have been omitted from NASCO 10. In common with all other NASCOs, NASCO 10 contains only the accounting requirements. All necessary explanations, and examples, are to be contained in the accompanying Explanations document.
- There are no other significant differences between NASCO 10 and IAS 37