

EXPOSURE DRAFT (ED)

**National Accounting Standard for Commercial Organisations
(NASCO) No10
Provisions¹, Contingent Liabilities, and Contingent Assets**

General Provisions	2
Objective	2
Scope	2
Definitions	3
Provisions and Definitely Determinable Liabilities	4
Provisions and Contingent Liabilities	4
Recognition	5
Provisions	5
Contingent Liabilities	7
Contingent Assets	7
Measurement	7
Best Estimate	7
Uncertainty	8
Present Value	8
Future Events	8
Expected Disposal of Assets.....	8
Reimbursements	9
Changes in Provisions	9
Use of Provisions	9
Application of the Recognition and Measurement Rules	9
Future Losses	9
Onerous Contracts	9
Restructuring	10
Disclosure	11
Transitional Provisions	12
First Time Application	12
Effective Date	12
Appendix 1 – Comparison with IAS 37, Provisions, Contingent Liabilities and Contingent Assets	13

¹ Translation into Russian and Azeri: ‘estimated liabilities’

General Provisions

1. This standard has been prepared in accordance with article 6 of the Accounting Law of Azerbaijan Republic and is based on International Accounting Standard 37 Provisions, Contingent Liabilities, and Contingent Assets.
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 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

5. This Standard should be applied in the presentation of all financial statements that are declared consistent with National Accounting Standards for Commercial Organisations.
6. This Standard applies to both the financial statements of an individual enterprise and to the consolidated financial statements of a group of companies.
7. This Standard applies to all types of commercial enterprises that prepare financial statements in accordance with Article 10 of the Accounting Law of the Azerbaijan Republic.
8. This Standard is to be applied in accounting for provisions, contingent liabilities and contingent assets, except:
 - (a) those resulting from financial instruments that are carried at fair value²;
 - (b) those resulting from the contracts under which neither party has performed any of its obligations or both parties have only partially performed their obligations to an equal extent, except where the contract is onerous;
 - (c) provisions related to construction contracts³;
 - (d) provisions related to income taxes (see NASCO 3, Current Taxation and NASCO 4, Deferred Taxation);
 - (e) provisions related to leases (see NASCO 9, Leases). However, as NASCO 9 contains no specific requirements to deal with operating leases that have become onerous, this Standard applies to such cases; and
 - (f) provisions related to employee benefits⁴.

² NASCO on Financial Instruments will be introduced at a later date

³ NASCO on Construction Contracts will be introduced at a later date

9. 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.
10. 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.
11. 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

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

A liability (as an element of financial statements) is a present obligation (legal or constructive) of the subject of accounting arising from past events (obligating events) that can be measured reliably and the settlement of which is expected to result in an outflow from the subject of accounting of resources embodying economic benefits.

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 provision is a liability of uncertain timing or amount.

A contingent liability is:

⁴ NASCO on Employee Benefits will be introduced at a later date

- (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.

13. Within this Standard the term 'contingent' is used only for liabilities and assets that are not recognised because their 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. The term 'contingent liability' is also used for liabilities that do not meet the recognition criteria.

Provisions and Definitely Determinable Liabilities

14. Provisions are different from definitely determinable liabilities because there is uncertainty about the timing or amount of the future expenditure required in settlement. This situation can be contrasted with definitely determinable liabilities such as:
- (a) Short Term Accounts payable to Suppliers are liabilities to pay for goods or services that have been received or supplied and have been invoiced or formally agreed with the supplier. There is no uncertainty about when such accounts are to be paid nor over the extent of the liability; and
 - (b) Accrued Liabilities are liabilities which have been incurred but have not been paid, invoiced or formally agreed in the current reporting period such as salary or interest accruals. Although it is sometimes necessary to estimate the amount or timing of accruals, the uncertainty is generally much less than for provisions.

Provisions and Contingent Liabilities

15. 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

16. A duty or responsibility of the subject of accounting to act or perform something in a certain way to other parties is to be recognized in the balance sheet if it meets the following criteria:
- (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.
17. A present obligation exists if the subject of accounting does not have the ability to avoid discharging of the liability under:
- (a) the terms of contract or current legislation; or
 - (b) the established pattern of past practice, published policies or a sufficiently specific current statement where the subject of accounting has indicated to other parties that it will accept and discharge the certain responsibilities.
18. Usually the liabilities are recorded at the amount of cash or cash equivalents payable to discharge the liability in the normal course of business or the amount of proceeds received in exchange for the obligation. However, reliable measurement does not exclude estimation.

Provisions

19. A provision is only to be recognised in the balance sheet and income statement when it meets all of recognition criteria of liability.

Present Obligations

20. 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

21. 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
22. 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.
23. 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.
24. 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

25. 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.

26. 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

27. 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

28. 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.
29. 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.
30. 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

31. Contingent assets are not to be recognized.
32. A contingent asset is disclosed where an inflow of economic benefits from the contingent asset is probable. If the expected inflow of economic benefits is not probable then no disclosure need be made.
33. 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

34. 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.

35. 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.
36. 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.
37. 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.
38. The provision is to be measured before any taxation considerations.

Uncertainty

39. 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.
40. Disclosure of the uncertainties surrounding the amount of the expected expenditure is to be made.

Present Value

41. 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

42. 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.
43. 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

44. 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

45. 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.
46. 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.
47. 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

48. 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. 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

49. 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

50. No provision is to be recognised for expected future losses that will arise from future activities.

Onerous Contracts

51. 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.

52. 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 contract⁵.

Restructuring

53. 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.

54. 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.

55. 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.

56. 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.

57. 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.

⁵ NASCO on Impairment of assets will be introduced at a later date

58. 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.
59. 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

60. 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.

61. 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,
 - (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.
62. 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.
63. Where a provision and a contingent liability both arise from the same set of circumstances, the disclosure of both must be made so as to make clear the link between the provision and the contingent liability.

64. 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.
65. Where any of the information required by this Standard is not disclosed because it is not practicable to do so, that fact must be stated.
66. If disclosure of some or all of the information required by 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.

Transitional Provisions

67. Paragraph 52 requires that 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. Until such time as the NASCO on impairment of assets has been introduced a subject of accounting shall not recognise any impairment loss.

First Time Application

68. 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

69. This Standard becomes operative for financial statements covering periods beginning on or after 1 January 200X.

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

This National Accounting Standard for Commercial Organisations (NASCO) 12 – Provisions, Contingent Liabilities, and Contingent Assets is drawn primarily from International Accounting Standard (IAS) 37 (revised 1998) – Provisions, Contingent Liabilities, and Contingent Assets. The main differences between NASCO 12 and IAS 37 are as follows:

- The General Provisions set out in paragraphs 1 to 3 are added to NASCO 12 and relate the standard to the Accounting Law of the Republic of Azerbaijan, the Rules of Bookkeeping and also in the Explanations and Recommendations on its Application. As distinct from IAS 37 NASCO 12 should be used taking into account the additional provisions contained in Rules of Bookkeeping and also in the Explanations and Recommendations on its Application.
- Paragraphs 5 to 7 of NASCO 12 define the scope of the organisations required to apply the standard as set out in the Accounting Law of the Republic of Azerbaijan.
- NASCO 12 contains the general recognition criteria of liability. IAS 37 does not contain such explanations.
- NASCO 12 does not use the term, employed in IAS 37, “executory contracts”, but accepts, and uses, the idea of such contracts.
- NASCO 12 contains the definition of “definitely determinable liabilities”. IAS 37 calls such liabilities as “other liabilities”.
- NASCO 12 contains definitions of ‘probable’, ‘possible’ and ‘remote’. IAS 37 does not contain such definitions.
- NASCO 12 requires that if some or all of the expenditure required to settle a provision is expected to be reimbursed by another party then 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. IAS 37 does not require but recommends this approach.
- According to NASCO 12 where the effect of the time value of money is material the discount rate that will be used to determine the present value of a provision reflects only the current market assessments of the time value of money. In addition to NASCO 12, IAS 37 requires it also to take into account the risks specific to the provision.
- NASCO 12 does not contain some examples that are introduced by IAS 37. These are included, and expanded on, in the Commentary to NASCO 12.
- NASCO 12 contains an extra section on transitional provisions, which postpones the introduction of some provisions of this Standard. It says that until such time as the NASCO on Impairment of Assets has been introduced a subject of accounting shall not recognise any impairment losses.
- NASCO 12 contains a section under First Time Application that provides regulations for those commercial organizations that apply NASCO 12 first time. Under this paragraph the 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.