

RESEARCH ARTICLE

Procedure and Methodology for Maintaining Bank Liabilities Accounting Under IFRS

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Abstract

This article discusses the interpretation of bank liabilities accounting in international financial reporting standards, and its history of origin and scope of application are widely covered based on analysis.

KEY WORDS

Bank liabilities, contingent liabilities, unconditional liabilities, contingent assets, estimated liabilities, valuation, risks and uncertainties, discount value, IAS 37, IFRS 9.

INTRODUCTION

Nowadays, the banking system of all developed countries maintains accounting records based on international financial accounting standards. In this regard, it is important to study the interpretation of the accounting for bank liabilities, which is part of bank passive operations, in international standards and learn about its history. We need to study in depth IAS 37 and IFRS 9, which are international financial reporting standards for accounting for bank liabilities. Both IFRS and IAS are standards to which companies must adhere in their financial statements.

This article will consider the aims of the standard, followed by the key specific criteria which must be met for a provision to be recognised. Finally, it will examine some specific issues which are often assessed in relation to the standard.

In April 2001 the International Accounting Standards Board adopted IAS 37 Provisions, Contingent Liabilities and Contingent Assets, which had originally been issued by the International Accounting Standards Committee in September 1998. That standard replaced parts of IAS 10 Contingencies and Events Occurring after the Balance Sheet Date that was issued in 1978 and that dealt with contingencies.

In May 2020 the Board issued Onerous Contracts—Cost of Fulfilling a Contract. This amended IAS 37 to clarify that for the purpose of assessing whether a contract is onerous, the cost of fulfilling the contract includes both the incremental costs of fulfilling that contract and an allocation of other costs that relate directly to fulfilling contracts.

Other Standards have made minor consequential amendments to IAS 37. They include IFRS 9 Financial Instruments (Hedge Accounting and amendments to IFRS 9, IFRS 7 and IAS 39) (issued November 2013), Annual Improvements to IFRSs 2010–2012 Cycle (issued December 2013), IFRS 15 Revenue from Contracts with Customers (issued May 2014), IFRS 9 Financial Instruments (issued July 2014), IFRS 16 Leases (issued January 2016), IFRS 17 Insurance Contracts (issued May 2017), Amendments to References to the Conceptual Framework in IFRS Standards (issued March 2018) and Definition of Material (Amendments to IAS 1 and IAS 8) (issued October 2018).

A provision is a liability of uncertain timing or amount. The liability may be a legal obligation or a constructive obligation. A constructive obligation arises from the entity's actions,

through which it has indicated to others that it will accept certain responsibilities, and as a result has created an expectation that it will discharge those responsibilities. Examples of provisions may include: warranty obligations; legal or constructive obligations to clean up contaminated land or restore facilities; and obligations caused by a retailer's policy to make refunds to customers.

An entity recognises a provision if it is probable that an outflow of cash or other economic resources will be required to settle the provision. If an outflow is not probable, the item is treated as a contingent liability.

A provision is measured at the amount that the entity would rationally pay to settle the obligation at the end of the reporting period or to transfer it to a third party at that time. Risks and uncertainties are taken into account in measuring a provision. A provision is discounted to its present value.

LITERATURE REVIEW

The main difference between IAS (International Accounting Standards) and IFRS (International Financial Reporting Standards) is their timing and structure. IAS are older standards (1973-2001), while IFRS are newer standards adopted after 2001. IFRS is now also used as a generic name, which also includes IAS standards. IAS 37 defines and specifies the accounting for and disclosure of provisions, contingent liabilities, and contingent assets. [9]

Our local scientist Sh.Z.Abdullaeva in her scientific research states that "passive operations of a bank - operations of banks related to the attraction of temporarily free funds are considered passive operations. One of the main tasks of a bank is to attract as much free funds as possible and invest them in other profitable optimal assets" – he emphasizes.[4]

Z. Mamadiyarov, M. Makhmudova, M. Kurbonbekova in their scientific research stated that "liabilities are formed at the expense of funds attracted by the bank, and capital is formed

at the expense of the bank's own funds. The formation of these funds at the expense of stable sources ensures the effective functioning and economic viability of commercial banks. Commercial banks balance passive voice main share obligations organization arrived, they 80– 90 from percent consists of will be. Obligations deadline and to the body arrival to the source looking at stable and unstable, can be divided into cheap and expensive funds based on the cost of their payment" – they thought.[3]

M.G'.Kenjayev, N.S.Ernazarov expressed the following opinions: "bank resources organization to grow with related was operations – passive operations It is said. Passive operations banking transactions from the outside funds attraction to grow and own funds organization to grow The bank's resources consist of its liabilities and its own capital. finds. Bank of activity again one main to oneself typical from the characteristics one from that "its resources consist mainly of external liabilities." [2]

METHODOLOGY

This article examines 37 IAS from the International Financial Reporting Standards on accounting for liabilities, which are important organizational components of the banking system. The methods of scientific evaluation, induction and deduction, comparison, and data analysis were used in the analysis process.

RESULTS AND DISCUSSION

The definition of a provision is key to the standard. A provision is a liability of uncertain timing or amount, meaning that there is some question over either how much will be paid or when this will be paid. Before the introduction of IAS 37, these uncertainties may have been exploited by companies trying to 'smooth profits' in order to achieve the results that their various stakeholders wanted.

Accrual vs Provision



1-picture[10]

For example, we will now consider a fictional company known as Zigger. At the start of the year, Zigger sets a profit target of \$10m for the year ended 31 December 20X8. The chief accountant of Zigger has reviewed the profit to date and realises they are likely to achieve profits of \$13m. The accountant knows that if Zigger reports a profit of \$13m, directors will not get any more of a bonus than if they reported \$10m. The chief accountant also knows that the profit target will be set at \$14m next year.

To avoid this, the accountant may be tempted to make some provisions for potential future expenses of \$3m, with the impact of making the profit seem lower in the current year. As the double entry for a provision is to debit an expense and credit the liability, this would potentially reduce profit to \$10m. Then in the next year, the chief accountant could reverse this provision, by debiting the liability and crediting the statement of profit or loss. This is effectively an attempt to move \$3m profit from the current year into the next financial year.

Clearly this is misleading for the users of the financial statements as they would have been given a false impression of the performance of the business. This is where IAS 37 is used to ensure that companies report only those provisions that meet certain criteria.

IAS 37 stipulates the criteria for provisions which must be met for a provision to be recognised so that companies are prevented from manipulating profits. According to IAS 37, three criteria are required to be met before a provision can be

recognised. These are:

1. There needs to be a present obligation from a past event
2. There needs to be a reliable estimate, and
3. There needs to be a probable outflow of resources embodying economic benefits (eg cash)

1. Present obligation from a past event

This rule has two parts, first the type of obligation; and second, the requirement for it to arise from a past event (something must already have happened to create the obligation).

(a) Type of obligation. The obligation could be a legal one, arising from a court case or some kind of contractual arrangement. Most candidates are able to spot this in exams, identifying the presence of a potential obligation of this type.

Alternatively, the obligation could be constructive. This is where a company establishes an expectation through an established course of past practice.

EXAMPLE

Hamkor Bank has a green finance policy in its accounting policy. Hamkor Bank explains that it always replants trees to offset the environmental damage caused by its operations. Hamkor Bank has a consistent history of respecting this policy. During 2025, a new factory opened near Hamkor Bank, which

caused environmental damage. Hamkor Bank estimates that the cost of planting trees and cleaning up the area will be \$400,000.

Even if there are no legal requirements in the country where Hamkor Bank operates that require it to replant trees, Hamkor Bank has a constructive obligation because it is confident in its securities, practices and history of green finance policies.

(b) Past event. The obligation needs to have arisen from a past event, rather than simply something which may or may not arise in the future.

EXAMPLE

A bank employee was injured at work in 2025 due to faulty equipment and is suing the bank. The bank was required to provide the best estimate of any damages that the employee would be entitled to. This is because the incident occurred in 2025 and, based on the available evidence, there is a present obligation.

If the lawyers have advised the bank that they will not be liable for the employee's injury, there will be no obligation as a result of the past event and therefore no condition will be recognized. The matter may require disclosure as a contingent liability. Contingent liabilities are explained in more detail below.

Similarly, the bank's management does not provide for claims that may arise from future injuries. This is because there is no past event that would give rise to the obligation and the potential claims can be avoided by implementing new safety measures or selling the bank's stock.

2. Reliable estimate

In an exam, it is unlikely that it will not be possible to make a reliable estimate of a provision. Likewise, it is unlikely that an entity will be able to avoid recording a liability when there is an obligation by claiming there is no way of producing an estimate of the amount. The main rule to follow is that where a single obligation is being measured, the best estimate will be the most likely outcome. If the provision being measured involves a large number of items, such as a warranty provision for repairing goods, the expected value should be calculated using the probability of all possible outcomes.

EXAMPLE – best estimate. Kapital bank has received legal advice that the most likely outcome of the court case from the employee is that they will lose the case and have to pay \$10m. The legal team think there is an 80% chance of this. They

believe there is a 10% chance of having to pay \$12m, and a 10% chance of paying nothing.

In this case, Kapital bank would provide \$10m, being the most likely outcome. It is not uncommon for candidates to incorrectly take the \$12m, thinking that the worst-case scenario should be provided for. Other candidates may calculate an expected value based on the various probabilities which also would not be appropriate in these circumstances. That is, it would be incorrect to provide for \$9.2m ($[80\% \times \$10m] + [10\% \times \$12m] + [10\% \times \text{nil}]$)

EXAMPLE – expected value. Asaka Bank provides a one-year warranty on all cars it loans out during the year. Past experience shows that Asaka Bank does not need 85% of its cars to be repaired. On average, 10% need minor repairs and 5% need major repairs. Asaka Bank's chief accountant has calculated that if all cars need minor repairs, it will cost \$100,000 and that overhauling all cars will cost \$1 million. Here, the inventory is valued at \$60,000. The expected cost of minor repairs is \$10,000 (10% of \$100,000) and the expected cost of overhaul is \$50,000 (5% of \$1 million). This is different from the "best estimate" example because there is no one-time payment, so the Asaka Bank chief accountant must calculate an estimate for all possible repairs.

3. Probable outflow

The final criteria required is that there needs to be a probable outflow of economic resources. There is no specific guidance of what percentage likelihood is required for an outflow to be probable. A probable outflow simply means that it is more likely than not that the entity will have to pay money.

If it appears that there is a possible outflow then no provision is recorded. In this situation, a contingent liability would be reported. A contingent liability is simply a disclosure note shown in the notes to the accounts. There is no double entry recorded in respect of this. Instead, a description of the event should be given to the users with an estimate of the potential financial effect. In addition to this, the expected timing of when the event should be resolved should also be included.

Similar to the concept of a contingent liability is the concept of a contingent asset. 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 entity. Like a contingent liability, a contingent asset is simply disclosed rather than a double entry being recorded.

Again, a description of the event should be recorded in addition to any potential amount. The key difference is that a contingent asset is only disclosed if there is a probable future inflow, rather than a possible one. The table below shows the treatment for an entity depending on the likelihood of an item happening.

Other issues within provisions

1. The time value of money. If the time value of money is material (generally if the potential outflow is payable in one year or more), the provision should be discounted to present value initially. Subsequently, the discount on this provision would be unwound over time, to record the provision at the actual amount payable. The unwinding of this discount would be recorded in the statement of profit or loss, separately, as interest expenses on the unwinding of discounts.

EXAMPLE

At 31 December 20X8, the legal advisors of Akmal now believe that the \$10m payment from the court case would be payable in one year. Akmal has a cost of capital of 10%.

On 31 December 2018, Akmal should record the provision at $\$10m \div 1.101$ year, which is \$9.09m. This should be debited to the statement of profit or loss, with a liability of \$9.09m recorded.

By 31 December 2019, when Akmal is required to make the payment, the liability should be showing at \$10m, not \$9.09m. Therefore, the liability is increased by 10% over the year, giving an increase of \$909,100 which would be presented as interest expenses on unwinding of discounts.

2. Restructuring costs Restructuring costs associated with reorganising divisions provide two issues. The first is to assess whether an obligation exists at the reporting date. The key here is whether the restructuring has been announced to the affected employees. If the employees have been informed, then an obligation exists and a provision must be made. If the employees have not been informed, then the company could change its mind. In this case, there is no present obligation to incur the costs associated with this.

The second issue for consideration is which costs should be included within the provision. These costs should exclude any costs associated with any continuing activities. Therefore, any provision should only include items such as redundancy costs and closure costs. Ongoing costs such as the costs of relocating staff should be excluded from the provision and

should instead be expensed as they are incurred.

3. Onerous contracts Onerous contracts are those in which the costs of meeting the contract will exceed any benefits which will flow to the entity from the contract. As soon as an entity is aware that a contract is onerous, the full loss should be provided for as a liability in the statement of financial position.

4. Decommissioning costs associated with assets So far, all the items considered in this article have involved the provision being recorded as a liability with the debit being shown as an expense in the statement of profit or loss. The exception to this is if an entity creates an obligation for future costs due to the construction of a non-current asset. In this case, the provision should be included within the original cost of the asset, as this is directly attributable to the construction of that asset.

EXAMPLE

Akmal constructed an oil platform in the sea on 1 January 20X8 at a cost of \$150m. As part of obtaining permission to construct the platform, Akmal has a legal obligation to remove the asset at the end of its 25-year useful life. This obligation has a present value of \$20m.

Here, Akmal would capitalise the \$170m as part of property, plant and equipment. As only \$150m has been paid, this amount would be credited to cash, with a \$20m provision set up. Over the useful life of the asset, the \$170m will be depreciated. In addition to this, the discount on the provision will be unwound and debited to interest expenses on unwinding of discounts. Consequently, the provision will increase each year until it becomes \$20m at the end of the asset's 25-year useful life.

5. Future operating losses Future operating losses do not meet the criteria for a provision as there is no obligation to make these losses. Therefore, they cannot be included in the financial statements.

CONCLUSION

In summary, reporting on bank liabilities based on IAS 37 ensures the competitiveness of the domestic banking system with foreign banking systems, and also determines the position of the bank among the international banking system, financial markets, and capital markets.

Analysis and audit of bank liabilities involves the assessment

of a bank's financial liabilities and debts. This is to ensure that the bank's liabilities recorded in its financial statements are accurate, completeness and reliability of providing important is a process. Analysis and audit helps identify any possible misstatements, errors or irregularities in the bank's passive accounts.

A bank's liabilities play a key role in financing its operations. Analyzing the maturity and stability of liabilities helps banks manage their liquidity effectively. Ensuring that short-term liabilities, such as customer deposits and interbank borrowings, have sufficient funds to meet the bank's immediate obligations for hard control to be done necessary. Obligation structure analysis to do through banks can plan their liquidity needs, maintain an appropriate balance between short-term and long-term funding sources, and reduce liquidity risks.

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