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## PROCEDURE FOR RECOGNITION, ASSESSMENT, AND REFLECTION IN REPORTING OF CONDITIONAL OBLIGATIONS

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### Abstract

The article analyzes the issues of recognition, valuation, and reflection in accounting of contingent liabilities. In modern economic conditions, the activities of enterprises are associated with possible uncertainties and risks, and in these cases, conditional obligations are of great importance. Contingent liabilities must be recognized in the financial statements as potential future liabilities, and reliable methods must be applied in the process of their valuation. The article analyzes international and national accounting standards, examines the criteria for recognizing and evaluating contingent liabilities, the procedure for reflecting them in accounting, and their impact on the transparency of financial reporting. The role of contingent liabilities in the corporate risk management system, their impact on investment decisions and strategic planning are also scientifically analyzed. According to the research results, it is shown that the correct recognition and assessment of contingent liabilities is the main condition for the financial stability and reliable reporting of the enterprise. The article emphasizes the importance of using methods such as probability, reliable assessment, and scenario analysis in assessing contingent liabilities and provides recommendations for practical application..

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## Introduction

In modern economic conditions, the activities of enterprises are carried out under the influence of a high degree of uncertainty, risk, and a changing external environment. As a result of increased competition, complicated legal relations, an increase in the types of financial instruments, and rapid changes in market conditions, enterprises face various obligations that may arise in the future. These circumstances further increase the importance of the concept of contingent liabilities in accounting.

Conditional obligations are contingent obligations arising as a result of past business transactions or other events of the enterprise, the fulfillment of which depends on the occurrence of certain conditions in the future. They are usually manifested in such cases as court cases, warranty obligations, results of tax audits, and the possibility of fines and compensations. The presence of such obligations can directly affect the financial stability, liquidity, and investment attractiveness of the enterprise.

One of the main goals of financial reporting is to provide interested users with reliable, complete, and objective information. From this point of view, the correct recognition, justified assessment, and accurate reflection in accounting of contingent liabilities play an important role in reflecting the real financial condition of the enterprise. If such obligations are not identified or incorrectly assessed in a timely manner, financial results may be distorted, risks may not be sufficiently disclosed, and the effectiveness of management decisions may decrease.

At the same time, international and national accounting standards establish specific criteria and requirements for the recognition and reflection in accounting of contingent liabilities. By complying with these requirements, enterprises ensure the transparency of financial reporting, strengthen the confidence of investors and creditors, and improve the quality of corporate governance.

This article provides a scientific and practical analysis of the criteria for recognizing contingent liabilities, methods for their assessment, and the procedure for reflecting them in accounting.

## Literature Review

Issues of recognition, valuation, and reflection of contingent liabilities in accounting are one of the most studied areas in the theory of international accounting. In the scientific literature, this category is analyzed in close connection with the concepts of uncertainty, risk, and professional judgment in financial reporting.

Robert N. Anthony, one of the prominent representatives of accounting theory, emphasizes that the main task of financial reporting is to accurately and objectively reflect the financial condition of the enterprise. In his opinion, insufficient disclosure of information about possible liabilities can lead users of financial statements to make incorrect decisions. Therefore, contingent liabilities should be considered as an important element of accounting policy [1][2] [3].

Scholars Barry Elliott and Jamie Elliott, who conducted research on financial reporting and international standards, note in their works that the criteria for assessing probability and reliability occupy a central place in the assessment of contingent liabilities. They scientifically substantiated the need to apply the principle of prioritizing economic essence over legal form in the formation of reserves. This makes it possible to reflect the level of real risk of the enterprise in the financial statements [2].

In international practice, standards developed by the International Accounting Standards Board are of great importance as one of the main regulatory sources for accounting for contingent liabilities. In particular, IAS 37 Provisions, Contingent Liabilities and Contingent Assets establishes specific requirements for the recognition and disclosure of contingent liabilities. In scientific research, this standard is assessed as a means of ensuring the principle of prudence in practice when taking risks into account [4][5][6].

Michel Crouhy, a renowned scholar in the field of risk management and corporate governance, considers contingent liabilities to be one of the most important sources of financial risk. In his opinion, potential liabilities related to lawsuits, guarantees, and tax uncertainties can directly affect the value of the  
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enterprise. Therefore, it is advisable to use scenario analysis and probabilistic modeling methods to assess them [4].

Some researchers, including Stephen Penman, have analyzed the impact of contingent liabilities on the transparency of financial reporting and argue that providing full disclosure about them reduces information asymmetry in capital markets. His research has scientifically proven that incorrect valuation of contingent liabilities can negatively affect stock prices and investor confidence [1].

National economists have also paid special attention to this issue. They analyze the impact of contingent liabilities on the financial stability and solvency of the enterprise and emphasize the need to introduce mechanisms for assessing risks in advance in accounting policies. It is especially noted that in the conditions of a transition economy, the share of contingent liabilities is high due to legal uncertainties and high market risk.

In general, the analysis of the opinions of scientists shows that the issue of recognition and measurement of contingent liabilities is not only a technical task of accounting, but also an important component of the processes of corporate risk management, investment decision-making and strategic planning. Therefore, it is urgent to deepen theoretical research in this area and develop innovative valuation methods suitable for practice.

### **Methodology**

In this article, a comprehensive methodological approach was used to scientifically substantiate the issues of recognition, valuation, and reflection of contingent liabilities in accounting. The harmonious application of theoretical, empirical, and comparative analysis methods in the research process made it possible to comprehensively cover the topic.

An important place in the study was occupied by the study of regulatory legal acts and accounting standards. Through a comparative analysis of the requirements established by national and international standards, similarities and differences between the criteria for recognizing contingent liabilities, valuation methods, and accounting procedures were identified. This approach made it possible to draw scientific conclusions on improving the accounting policy used in practice.

In addition, the use of economic and statistical methods made it possible to take into account the level of probability when assessing contingent liabilities, determine the expected value, and analyze the level of risk. In some cases, the method of expert assessment was applied, and the issues of determining the amount of contingent liabilities based on the conclusions of legal and financial specialists were considered.

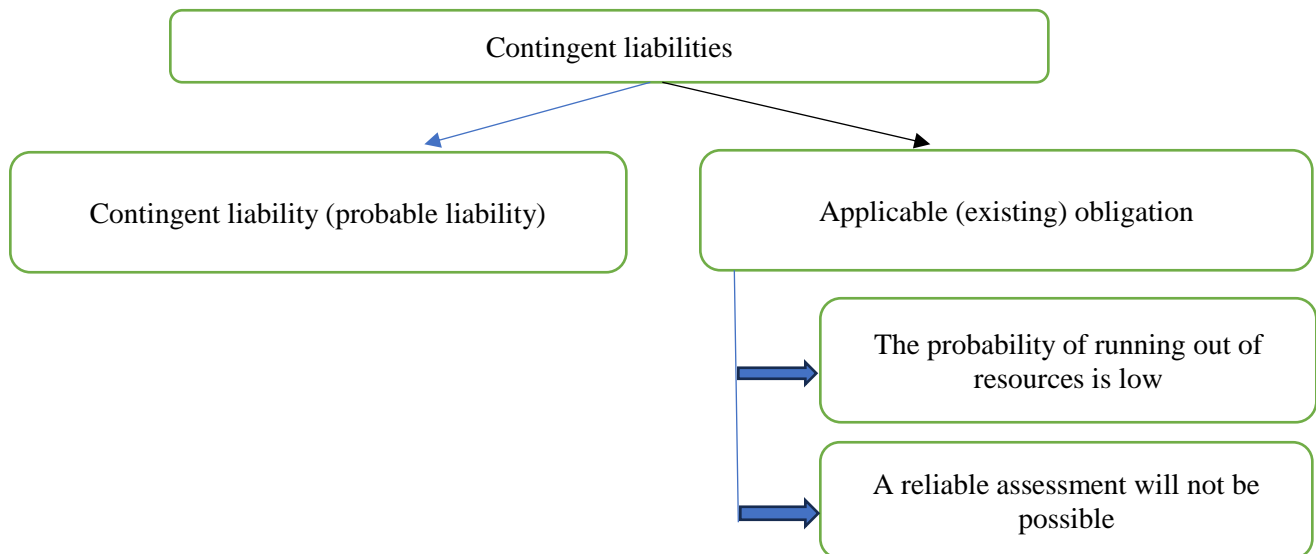
Thus, the methodological approach used in the article made it possible to comprehensively study the issues of recognition, assessment, and reflection in accounting of contingent liabilities, enriching theoretical conclusions with practical recommendations.

### **Results**

Contingent liabilities are obligations that may arise as a result of past events. Their actual occurrence is confirmed by the occurrence of one or more future events that may or may not occur and are beyond the control of the company.

Similarly, a constructive obligation that arises from past events may not be recognized if it is not sufficiently probable that an outflow of resources embodying economic benefits will be required to settle the obligation.

Contingent liabilities are not reflected in the balance sheet. It is advisable to record them in off-balance sheet accounts. Contingent liabilities should be disclosed in the disclosures to the financial statements. (Figure 1).



**Figure 1. Conditional obligation.**

Contingent obligation formula:

Contingent Obligation = A possible obligation arising from past events and (or) the probability of its occurrence is remote and (or) cannot be reliably estimated.

**Procedures for estimating contingent liabilities at an enterprise.** The Good Food company prepares and sells shawarma and other fast food dishes. The company is famous for the quality and taste of its dishes. The company has a large number of customers, it is always crowded with customers. However, 3 of the large number of customers went to the hospital with a diagnosis of food poisoning from other foods. Their parents believe that the children were poisoned by shawarma. They went to court demanding that the company pay 30,000,000 soums in compensation for the damage caused. The parents and their lawyers believe that they are obliged to pay compensation. Based on previous similar cases and the evidence presented, the lawyers of this company conclude that the probability of losing the case is 30%, and the probability of winning is 70%. How is the information in this case reflected?

The following test is performed to recognize this obligation.

**Table 1. Assessment of Contingent Liability Based on Probability of Resource Outflow**

Conditions	Availability of commitment	Possible outflow of resources	Credibility assessment	Outcome
Quality service	Yes	Less than 50%	Yes	Contingent commitment

In this case, since the probability of outflow of resources is less than 50%, this obligation is considered a contingent liability and is disclosed in the financial statements.

The company received a guarantee from the intermediary that the obligation to provide services to the client for half a year will be fulfilled.

The company is confident that it will not be sued, since the agent is not interested in this at all. However, the risk that the agent will not be able to fulfill its obligations to the client for reasons beyond its control remains in any case.

The issue needs to be resolved. Whether the company has an obligation or not. This issue will be clarified depending on whether the customer files a claim within half a year or not.

The company is sued by the buyer in the amount of 550,000,000 soums. The company's lawyers studied the case and concluded that the penalties are not large, the plaintiff does not have substantiated evidence,

all clauses of the contract have been fulfilled, and the quality of the products meets the requirements of world standards.

In any case, the claim must be assessed by the company as a contingent liability and disclosed in the notes to the financial statements.

The standard defines contingent assets as assets that arise from past events not wholly within the control of the company and whose settlement depends on the occurrence or possibility of one or more uncertain future events [7][8].

As an example, we can take claims, the satisfaction of which the company can achieve through the court.

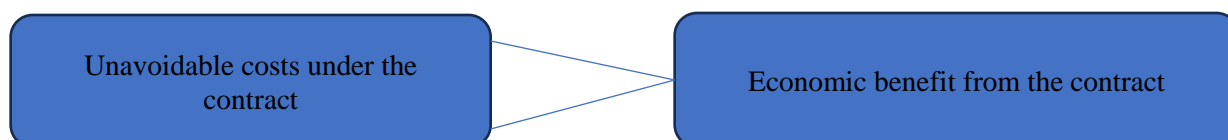
The company filed a lawsuit against its suppliers to recover 1,550,000,000 soums under the supply agreement. The lawsuit was sent to court. In previous years, the company had won a similar lawsuit. According to lawyers, this time the company is confident that it will win in court.

This court dispute can negatively affect the company's reputation. The company that is litigating, the company that is filing the dispute, can lower its position in front of its competitors. Therefore, it is advisable not to disclose this fact in the financial statements until there is a high probability of winning.

If, based on the court's decision and the assessment of lawyers, the issue is likely to be resolved in the company's favor, accounting is required to assess this situation as a contingent asset and disclose it in the financial statements.

If, based on the court's decision, the issue is resolved in favor of the company, that is, if the court awards 1,550,000,000 soums and the supplier is finally obliged to pay this amount, the contingent asset is converted into an unconditional asset, that is, a receivable, and is reflected in the balance sheet.

Obremenital contracts are contracts in which unavoidable costs related to the fulfillment of obligations under this contract exceed the economic benefits expected from its fulfillment (Figure 2).



**Figure 2. Obremenital contract features.**

Non-avoidable costs include the minimum net costs of performing the contract and the amount of compensation and liquidated damages payable in the event of non-performance of the contract.

If the company has onerous contracts, the existing obligations under these contracts must be recognized and measured as a contingent liability.

Accounting for onerous contracts. Laing Alarko JV, a joint venture between the UK-based construction company Laing and the Turkish company Alarko, is undertaking a construction project at the request of a local authority with an estimated cost of US\$550,000. This is work that is necessary to strengthen the company's position in a new market. The customer has indicated that he will make a payment of US\$350,000 for this work. If this contract is signed, it is an onerous contract because the costs of its performance exceed the economic benefits expected from the contract. Therefore, the company should estimate and recognize a liability of US\$200,000 (550-350) as a measured liability.

Restructuring is a program that involves planned and controlled changes in a company's operations. These include: [9][10]

- a) the scope of activities carried out by the company; or
- b) the method of operation

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Examples of restructuring processes include:

- a) the sale or termination of a line of business;
- b) the closure of certain business units in a company or region or the transfer of business activities from one country or region to another;
- c) changes in the management structure, the elimination of management levels; and
- e) a fundamental reorganization that significantly affects the nature of the company's activities.

The decision on restructuring is not made by only one manager. It is advisable to discuss it in the Management Board, Board of Directors, founders' meetings, general meetings of the joint-stock company and ensure the participation of all bodies.

The management of the company, after analyzing the segmental financial statements of the Board, comes to the conclusion that, for example, the operation of Nottingham in Angelia is making a loss. Therefore, he decided to close the activity in this region. As a result of this closure, it is expected to pay \$25,000,000 in fines to customers for breach of customer obligations and severance payments to employees due to reduced activity.

The decision to terminate the activity has been made and this decision has been communicated to all instances. Payment of funds in the amount of 25 million USD cannot be avoided. In this case, the company is required to recognize the costs of the restructuring process in the amount of 25 million USD as an estimated liability and reflect it in the balance sheet.

A furniture purchasing trading company, based on strategic market research, concludes that it is now suitable for the purpose of starting its own furniture production activities. For this, the company will have to prepare legal documents, purchase premises, equipment and technology for 15 million USD.

If the company has developed a plan for future restructuring, a decision has been made, but has not yet announced it, then in accordance with IAS 37, these future liabilities are not yet recognized and are not reflected in the financial statements.

If the restructuring plan has been discussed and approved by the Board of Directors, and the decision has been announced and work has begun, the company should recognize \$15 million as restructuring costs and record it as a provision on its balance sheet.

Provisions for restructuring should include the direct costs of the restructuring, which must meet the following two conditions: [3]

- a) Resulting from restructuring;
- b) Not related to the company's current activities.

The company is required to disclose for each class of reserves in accordance with the standard requirements:

- The balance sheet amount at the beginning and end of the reporting period and its movements in the following types:

- Additional reserves and increases in existing reserves;
- Use of the amount during the period (expended or accrued against the reserve);
- Amounts not used and recovered during the period;
- Discounted amounts.

- A brief description of the obligations and the amount and time of the intended outflow of economic interest;
- Uncertainties regarding the withdrawal amount and time;
- Amount of pending coverages.

Companies are also required to provide disclosures about contingent assets and contingent liabilities in their financial statements. The disclosures include a brief description of each class of contingent liabilities, the estimated financial impact, and the amount or period of the outflow of resources.

From the above, it can be concluded that estimated liabilities, contingent liabilities, and contingent assets are important accounting items, and their disclosure or disclosure in financial statements serves to increase the transparency of financial reporting.

## Conclusion

The results of the study show that contingent liabilities are of great importance in the complete and fair presentation of the financial statements of the enterprise. In the conditions of the modern economy, as a result of legal complexity, market risk and the increase in financial transactions, the share of contingent liabilities is increasing. Therefore, their correct recognition, measurement and accounting are of decisive importance in accurately assessing the financial stability, liquidity and solvency of the enterprise.

Contingent liabilities are not only a technical element of accounting, but also an important part of the corporate risk management system. They create a reliable source of information for investors, creditors and other interested parties by identifying potential losses in advance and reflecting them in financial statements. Thus, the reliability and transparency of financial reporting increases, the effectiveness of corporate governance and the clarity of strategies are ensured.

The international standards used in the study, including IAS 37 Provisions, Contingent Liabilities and Contingent Assets, developed by the International Accounting Standards Board, set out clear rules for the recognition and disclosure of contingent liabilities. Based on these standards, enterprises can use the criteria of probability, reliable estimation and historical experience to estimate liabilities and reflect their true impact in their financial statements.

The study also states that contingent liabilities, in addition to accounting, are closely related to corporate strategy, investment planning, and risk management processes. By providing complete and accurate information about them, the company's management can assess in advance the financial and legal risks that may arise in the future. This allows for increased efficiency in strategic decisions, rational allocation of resources, and control over financial flows.

In general, the main conclusion of the study is that the recognition, measurement and accounting of contingent liabilities is not just an accounting task, but a strategic tool that ensures the sustainable development and investment attractiveness of the enterprise. Therefore, in this area, it is very important to improve national norms and accounting policies based on international standards, improve the professional skills of accountants and financial managers, and integrate them with the corporate risk management system.

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