

ASBG 8 PROVISIONS, CONTINGENT LIABILITIES AND CONTINGENT ASSETS

TABLE OF CONTENTS	clauses
OBJECTIVE AND BASIS FOR PREPARATION	1–2
SCOPE	3-5
DEFINITIONS	6-8
RECOGNITION OF PROVISIONS – GENERAL RULES	9-23
Formation of Provisions	9-14
Assessment of Provisions	15-20
Use of Provisions	21-22
Reimbursements from third parties	23
RECOGNITION OF PROVISIONS – SPECIFIC AREAS	24-47
Guarantee Provisions	24-25
Provisions Related to Court Cases	26-27
Provisions Related to Onerous Contracts	28-29
Provisions Related to Environmental Damage	30-32
Provisions for Restructuring Costs	33-37
Termination benefits provisions	38-39
Provisions for pensions or other post-employment benefits	40-42
Deferred Income Tax and Income Tax on Dividends	43-47
CONTINGENT LIABILITIES	48-49
CONTINGENT ASSETS	50-51
COMPARISON WITH IFRS FOR SMES	52-54

OBJECTIVE AND BASIS FOR PREPARATION

1. The objective of Accounting Standards Board's guideline ASBG 8 "*Provisions, Contingent Liabilities and Contingent Assets*" is to prescribe rules for the recognition of provisions, contingent liabilities and contingent assets in the financial statements prepared in accordance with the Estonian financial reporting standard (hereinafter also *the financial statement*). Estonian financial reporting standard is a body of financial reporting requirements directed at the public and based on the internationally accepted accounting and reporting principles, which principal requirements are established by the Accounting Act and which is specified by a regulation of the minister responsible for the area established on the basis of subsection 34 (4) of the Accounting Act (hereinafter *guideline of the Standards Board* or for short *ASBG*).
2. ASBG 8 is based on IFRS for SMEs sections 21 "*Provisions and Contingencies*", 28 "*Employee Benefits*" and 29 "*Income Tax*" and concepts defined in "*Glossary of Terms*". The guideline contains references to the specific paragraphs of IFRS for SMEs that the requirements of the guideline are based on. The comparison of ASBG 8 with IFRS for SMEs is presented in clauses 52-54. In areas where ASBG 8 does not specify a particular accounting policy but that are covered by IFRS for SMEs, it is recommended to abide by the accounting policy described in IFRS for SMEs.

SCOPE

3. **ASBG 8 "*Provisions, Contingent Liabilities and Contingent Assets*" shall be applied:**
 - (a) ***upon setting up, accounting for and measuring provisions (e.g. guarantee provisions, provisions related to litigation and pension provisions) in financial statements;***
 - (b) ***in reporting deferred income tax and income tax on dividends, and***
 - (c) ***in reporting contingent liabilities and contingent assets in the financial statements.***
4. ASBG 8 provides a definition for the term "provision" and explains the difference between a provision and a contingent liability. The guideline describes situations when the recognition of a provision is necessary in the balance sheet and when it is sufficient to disclose a contingent liability in the notes to the financial statements.
5. ASBG 8 shall not be applied to:
 - (a) accounting for such specific provisions that are regulated by other guidelines of the Board (e.g. setting up provisions in business combinations– see ASBG 11 "*Business Combinations*" and accounting for subsidiaries and associates");
 - (b) account for provisions in the financial statements of insurance companies arising from insurance contracts.

DEFINITIONS

6. *The following terms are used in this guideline with the meanings specified:*

A provision is a liability of uncertain timing or amount. (IFRS for SMEs 21.1)

Liability is an existing obligation of an accounting entity

- (a) *which arises from the past events; and*
- (b) *and the release from which is expected to reduce the economically useful resources. (IFRS for SMEs 2.15).*

An obligating event is an event that creates either a legal or a constructive obligation for the entity, without a realistic alternative not to settle the obligation.

Constructive obligation is an obligation, arising from:

- (a) *an agreement (through its direct or indirect conditions); or*
- (b) *from legislation or other legal grounds. (IFRS for SMEs 2.20)*

Constructive obligation is an obligation, arising from the entity's practice, for which:

- (a) *by an established pattern of past practice, published policies or a sufficiently specific current statement, the entity has indicated to other parties that it will accept certain responsibilities; and*
- (b) *as a result, the entity has created a valid expectation on the part of those other parties that it will discharge those responsibilities. (IFRS for SMEs 2.20)*

A contingent liability is a possible or present obligation,:

- (a) *the settlement of which is not probable; or*
- (b) *whose amount cannot be measured with sufficient reliability. (IFRS for SMEs 2.40, 21.12).*

Contingent asset is a possible asset 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. (IFRS for SMEs Glossary of Terms).

7. Provisions are distinguished from other liabilities (e.g. trade payables, borrowings, etc.) because there is uncertainty about the timing or amount of the future expenditures required in the settlement. Generally, the amount used as basis for recognising liabilities is determined in an invoice, a contract or some other document and there is no need for the application of accounting estimates. In recognising provisions in the balance sheet, the opinion of management or other experts regarding the amount probably needed for settling provisions or the timing of provisions shall be used as the basis. Since the measurement of provisions is based on estimates that might not always be precise, it is important to recognise and report them separately from other liabilities.

8. There is even more uncertainty regarding contingent liabilities than provisions. If the settlement of provisions is probable and the amount can be estimated relatively reliably, the settlement of contingent liabilities is either improbable or the amount cannot be estimated reliably.

GENERAL RULES FOR RECOGNISING PROVISIONS

Formation of Provisions

9. An entity shall recognise a provision only when (IFRS for SMEs 21.4, 21.5):

- (a) the entity has a legal or constructive obligation at the reporting date as a result of a past event;**
- (b) it is probable that the entity will be required to transfer economic benefits in settlement; and**
- (c) the amount of the obligation can be estimated reliably.**

10. An entity shall recognise a provision in its balance sheet only when the obligating event has occurred before the reporting date. (IFRS for SMEs 21.6).

Example 1 – Occurrence of a legal obligation

The following are examples of obligating events which result in a legal obligation for an entity:

- a) breach of contract between the parties, which provides grounds to the other party to claim damages;
- b) violation of tax law, which provides grounds to the tax board to demand payment of additional taxes or fines (regardless of whether or not the tax board has discovered the violation);
- c) entry into force of an environmental law that requires the entity to mitigate or compensate for certain contamination.

11. In case of a constructive obligation, there is no legal basis to demand settlement of an obligation from an entity. At the same time the entity has with its activities or specific statements raised reasonable expectations in other parties that the obligation will be settled and hence its non-settlement is improbable. (IFRS for SMEs 21.6).

Example 2 – Occurrence of constructive obligation

The following are examples of situations that result in a constructive obligation for an entity:

- a) an entity has disclosed its policy of buying back the sold goods within one month if the customer is not satisfied with them. The entity has followed this policy although it has no legal obligation to do so. Since the buyers have reasonable expectations regarding the return of goods and it is probable that the entity will also keep its promise in the future, the entity creates a provision in its balance sheet for the expected costs related to the repurchase of goods. An obligating event is the time of the sale of goods;
- b) the Supervisory Board of an entity makes an oral promise to the management that in case of good results a certain percentage of the entity's profit will be paid out as bonuses to them. Although the entity has no legal obligation to keep the promise, a similar practice has been followed for several years and the management has reasonable expectations that the entity will keep this promise. An obligating event is the time when the management was informed of the probable bonus percentage;
- c) before the reporting date, an entity has disclosed that during the reconstruction

programme a certain number of employees would be laid off and a total of 10,000 euros would be paid to them as termination benefits. Although the entity has no legal obligation to implement the reconstruction programme by the reporting date, the disclosure of this intention has raised valid expectations in other concerned parties, as a result of which it is probable that the entity will adhere to its decision. An obligating event is the time of disclosing the reconstruction programme.

12. A provision shall be recognised in the balance sheet only if the probability of its settlement is greater than 50% (i.e. settlement is more probable than non-settlement). If the probability of settlement is less than 50%, a provision will not be recognised, but the expected liability shall be disclosed as a contingent liability in the notes to the financial statements.

13. It is generally possible to make a reliable estimate of the size of the necessary provision (i.e. the amount accompanying the provision). In rare cases, where no reliable estimate can be made of the amount of the provision, the provision shall not be recognised in the balance sheet, but the factors related to it shall be disclosed as a contingent liability in the notes to the financial statements.

14. Setting up a new provision or increasing an existing provision is normally recorded as an expense for the accounting period. In case formation of the provision relates to an acquisition of a new asset, the amount of such a provision shall be added to the cost of this asset. (IFRS for SMEs 21.5).

Assessment of Provisions

15. *The amount recognised on the balance sheet as a provision shall be in the management's opinion the best estimate of the expenditure required to settle the present obligation as at the reporting date. (IFRS for SMEs 21.7).*

16. At each reporting date, the management of an entity shall assess the need for setting up new provisions and revaluing or reversing existing provisions. A provision shall be recognised in the amount which is probably necessary for the settlement of the related obligation or transferring it to a third party. (IFRS for SMEs 21.7, 21.11).

17. The amount necessary for the settlement of an obligation relating to the provision often depends on several external factors whose development the entity cannot control but whose probability can be usually estimated. In measuring provisions, the probability of different possible scenarios should be considered. (IFRS for SMEs 21.7 (b)).

Example 3 – Assessment of Provisions

a) An action has been filed against an entity, whose procedure is still underway at the reporting date. The lawyers of the entity estimate that the costs related to the action are likely to be within the range of 10 000 to 20 000 euros, whereas the probability of expenses in this range is even. The entity recognises a provision in the amount of 15 000 euros in its balance sheet.

b) An entity provides a one year warranty for its products. The past experience of the entity has shown that 90% of the products have no defects, 9% have minor defects and 1% have

significant defects. Repairing minor defects would cost about 10% of the sales price and repairing significant defects about 80% of the sales price. Last year, the sales revenue of the entity was 10 million euros and the entity has already spent 50,000 euros for repairing defective products sold last year.

The estimated costs related to the warranty repair of products are as follows:

$$0.09 \times 10,000,000 \times 0.1 + 0.01 \times 1,000,000 \times 0.8 = 90,000 + 80,000 = 170,000$$

Since the entity has already incurred costs in the amount of 50,000 euros related to the warranty repair of products sold the same year, a warranty provision in the amount of 120,000 euros (170,000 – 50,000) shall be recognised in the balance sheet.

18. *In case the provision is likely to be settled later than 12 months after the reporting date, it shall be recognised at its discounted value (i.e. in the present value of the payments related to the provision), except when the impact of discounting is immaterial. (IFRS for SMEs 21.7) A single exception is the deferred income tax provision that shall not be discounted. (IFRS for SMEs 29.23).*

19. In calculating the present value, the discount rate used shall be the market interest rate for similar liabilities. The interest rate must reflect the risks related to the liability, unless they have already been reflected in the estimations of payouts related to provisions. (IFRS for SMEs 21.7).

20. The increase of the discounted value of long-term provisions related to the approaching of the settlement term shall be recorded as an interest expense in the income statement. (IFRS for SMEs 21.11).

Use of Provisions

21. *Provisions shall be used only for the expenditures for which the provision was originally set up. (IFRS for SMEs 21.10).*

22. No other expenditures shall be set against a provision, as it would distort the objective nature of the financial statements of an entity.

Reimbursements from third parties

23. Where an entity has the right to demand the reimbursement in conjunction with a certain provision from a third party (incl. from insurer), the reimbursement receivable shall be recognised as an asset on the balance sheet only if it is virtually certain that the entity will receive it. The receivable recognised for the reimbursement shall not exceed the amount of the provision. The reimbursement receivable and provision shall be recognised separately on the balance sheet and shall not be offset against each other. It is acceptable to present expenses accompanying the formation of a provision or the income related to the recognition of a reimbursement receivable as a net amount in the income statement. (IFRS for SMEs 21.9).

Example 4 – Reimbursements from third parties

An action has been filed against an entity in conjunction with the poor quality of the products sold by it. According to the lawyers' estimate, the costs relating to the action

would be in the 10 000 euro range. At the same time, the entity has filed an action against its subcontractors to demand compensation for a potential damage. According to the lawyers it is most likely that in case the entity loses the first case, it will receive at least 8,000 euros from subcontractors as compensation.

The entity recognises a provision in the amount of 10 000 euros and a receivable from the subcontractor in the amount of 8 000 euros in its balance sheet. In the income statement, the expense related to the court case will be recorded as a net amount of 2 000 euros.

RECOGNITION OF PROVISIONS – SPECIFIC AREAS

Warranty Provisions

24. In case an entity provides warranties on the goods it sells, a provision shall be set up and recorded in the balance sheet of the entity in the amount necessary for settling the warranty obligations for the products sold by the reporting date. The obligating event is the sale of goods subject to warranty. Past experience is used as the basis for the measurement of provisions. (IFRS for SMEs 21.A4) On the calculation of guarantee provision, see example 3 (b).

25. If an entity that has sold the goods (e.g. a sales company) is not liable for the settlement of warranty obligations, but mediates a warranty provided by another entity (e.g. a manufacturing company), then it shall not recognise a warranty provision in its balance sheet.

Provisions Related to Court Cases

26. An entity shall recognise a provision in its balance sheet related to all court cases and possible court cases in which case:

- (a) obligating event causing court litigation took place before the reporting date;
- (b) it is probable that an outflow of resources will be required to settle the litigation;
- and
- (c) a reliable estimate can be made of the amount of the expenditure resulting from litigation.

If the above-mentioned conditions are not met, no provision shall be not set up or recognised in the balance sheet, but the circumstances related to the litigation shall be disclosed as contingent liability in the notes to the financial statements. See example 3 (a) on calculating a provision set up for litigation.

27. Although only a rough estimate can often be made of the amount related to the court case, this is not a reason for not setting up a provision. Only under rare circumstances when the amounts related to the court cases can be very different under different scenarios and the probability of these scenarios cannot be estimated reliably, no provision shall be recognised in the balance sheet but the circumstances related to the court case shall be disclosed in the notes to the financial statements.

Provisions Related to Onerous Contracts

28. An onerous contract is a contract in which the incremental costs of meeting the obligations under the contract exceed the probable economic benefits expected to be received under it. (IFRS for SMEs 21.A2, IFRS for SMEs Glossary of Terms)

29. A provision shall be set up for onerous contracts in an amount lower of the following two (IFRS for SMEs 21.A2):

- (a) the loss incurred by fulfilling the contract (i.e. income from the contract less expenses resulting from fulfilling it); or
- (b) contractual penalty arising from contract termination.

Example 5 – Setting up of a provision related to an onerous contract

a) An entity leases certain production facilities under an operating lease, paying a rent of 10 000 euros a year. At 31.12.20X1, the entity moves into a new production facility but the lease agreement for the old facility will expire only in three years, at 31.12.20X4. Upon terminating the contract, the entity would have to pay a contractual penalty in the amount equalling two year's rent (i.e. 20 000 euros). If the entity leased out the space, it would receive rental income of about 7 000 euros a year (i.e. the entity would incur a loss of 3 000 euros a year on the lease agreement within the next three years).

The entity records a provision of 9,000 euros in the balance sheet relating to the onerous lease agreement (if the impact of discounting is material, the provision for years 2 and 3 should be discounted).

b) An entity engaged in milk production entered into a long-term agreement with the suppliers for the buying-in of raw milk for the price of 0.4 euros per litre. At the end of 20X1, the market price of raw milk (and also the sales price of milk) had significantly fallen. As at 31.12.20X1, pursuant to the contract the entity was required to purchase another 100,000 litres of raw milk for the price of 0.4 euros per litre, although the management estimated that the purchase price of raw milk should have been about 0.3 euros by then for the entity not be operating at a loss. Upon terminating the agreement, a contractual penalty of 5 000 euros would have to be paid.

This is an onerous contract because the unavoidable costs related to the contract exceed the probable income from the contract. The entity shall report a provision at the lower of the costs related to the fulfilment of the contract (0.1 euros/litre x 100,000 litres = 10,000 euros) and the contractual penalty (5,000), hence in the amount of 5,000 euros.

Provisions Related to Environmental Damage

30. In its balance sheet, an entity shall record a provision for environmental damage that occurred before the reporting date, if:

- (a) legislation requires the mitigation of or compensation for the particular damage;
- or
- (b) the entity has proved with its good environmental record and disclosed operational policies that it intends to voluntarily mitigate the environmental damage.

31. A provision shall be established for environmental damage equalling the costs related to the mitigation of the damage (including potential additional fines). If instead of mitigating the damage, the entity prefers to pay the fines, a provision shall be recognised in the amount of the potential fine.

32. If environmental damage has occurred as a result of an acquisition or construction of a new asset (e.g. construction of a mine), then the amount of the provision shall be included in the cost of the asset.

Provisions Related to Restructuring Costs

33. Restructuring is a thorough reorganisation of an entity's operations controlled by and based on a specific activity plan carried out by the management of an entity as a result of which either the scope or manner of business undertaken by the entity will materially change. (IFRS for SMEs 21.A3)

34. Examples of restructuring are the sale or liquidation of a line of business; the closure or relocation of certain major production unit, material changes in the management structure leading to a lay-off of some management members.

35. A constructive obligation has arisen in conjunction with the restructuring programme and the entity shall recognise a provision in its balance sheet only if the management has before the reporting date (IFRS for SMEs 21.A3):

- (a) compiled a detailed official restructuring programme which includes the description of the business units to be restructured, planned changes in the number of employees, the resulting expenditures and the planned schedule; as well as
- (b) has either disclosed the main points of the restructuring programme or has started to implement the restructuring programme, raising valid expectations in other concerned parties regarding the implementation of the restructuring programme.

36. A restructuring provision shall be set up only for one-time direct expenditures for restructuring which are not associated with the post-restructuring operations of an entity. Examples of restructuring costs that warrant the setting up of a provision, are:

- (a) costs related to the lay-off of employees;
- (b) costs related to the closure of a production unit; and
- (c) costs related to the contracts that have become onerous as a result of restructuring (e.g., lease agreements which become onerous for the entity after the restructuring).

37. A restructuring provision shall not be set up for the following expenditures as they are not related to the restructuring itself but to the business operations after the restructuring:

- (a) costs related to retraining and relocating employees;
- (b) marketing expenditures; and
- (c) costs related to the development of new systems.

Example 6 – Recognition of restructuring provision.

a) At 12.12.20X1, the entity's management board decided to shut down one production division. By the reporting date (31.12.20X1), relevant information had not yet been sent to the employees potentially affected by the division closure and other steps had also not been taken to implement the decision.

As no obligating event took place before the reporting date, no provision is recorded on the balance sheet.

b) At 12.12.20X1, the entity's management board decided to shut down one production division. At 20.12.20X1, the management board approved a detailed plan for shutting down the division. Customers were sent letters, informing them of the decision to wind up production and recommending them to find alternative suppliers for buying this product. Also, the employees of the department were sent notice of dismissal.

The entity shall record a provision on its balance sheet because:

- i) an obligating event took place before reporting date - communication to customers and employees of the division closure causes a constructive obligation because it results in other parties' expectation that the division will be shut down;
- ii) it is probable that an outflow of resources will be required to settle the obligation.

The provision shall be made based on the entity's best estimate as to costs resulting from division closure.

Termination benefits provisions

38. Termination benefits are payments made on the basis of an obligation of the entity, which are paid when (IFRS for SMEs 28.31, 28.34):

- (a) an entity decides to terminate the employment of an employee prior to the term of the employment contract; or
- (b) an employee decides to leave employment voluntarily and receives termination benefits in return.

39. An entity shall recognise termination benefits as a provision on its balance sheet and an expense in its income statement when the entity has a constructive obligation with regard to the benefits, i.e. the entity's management has prior to the reporting date made a decision to terminate the employment of an employee or to provide termination benefits as a result of an offer made in order to encourage voluntary redundancy and has notified the employee of such decision. (IFRS for SMEs 28.32, 28.34, 28.35)

Example 7 - Date of recognising termination benefits provision

An entity enters into a contract with its management board member for a two-year term. Pursuant to the contract, the management board member is paid benefits (of two month's salary) if:

a) the contract is terminated prematurely at the entity's initiative.	A provision for payment of benefits must be recorded when the decision is made to prematurely terminate the contract.
b) the contract is not extended as it expires.	A provision for payment of benefits must be recorded when the decision is made not to extend the contract.
c) the contract is terminated prematurely at the management board member's initiative.	Post-employment benefits shall apply, which shall be recognised based on clauses 40-42, i.e. at the date of entry into the contract, a provision must be recorded on the balance sheet at the present value of the benefit payable.

Provisions for pensions or other post-employment benefits

40. If an entity has assumed the obligation to pay pensions or other post-employment benefits to its employees, the entity is required to recognise a provision in its balance sheet to cover expenditures related to the payment of pensions or other post-employment benefits. (IFRS for SMEs 28.14).

41. In setting up a pensions or other post-employment benefits provision, an entity shall estimate the amount of the payments to be made in the following periods and calculate their present value. In measuring such provision, the estimated remaining life expectancy of legal subjects entitled to receive benefits, an inflation estimate and increases in salaries (in case the size of the benefits depends on these variables) shall be used. (IFRS for SMEs 28.15, 28.18) The discount rate used will be the interest rates of high-quality corporate bonds or government bonds as at the reporting date. (IFRS for SMEs 28.17).

42. This guideline does not set out a detailed method to account for pension provisions and other post-employment benefits, as according to the Board the accounting for these areas has relevance only for a relatively small number of entities in Estonia. If necessary, the Board recommends the use of the methods described in section 28 of IFRS for SMEs. In measuring pension provisions, it is recommended to use the help of specialists with relevant qualifications (actuaries).

Deferred Income Tax and Income Tax on Dividends

43. Deferred income tax assets and liabilities arise because the carrying amount of certain assets and liabilities may differ from their value in tax accounting and hence impact the accounting for income tax in the current and following accounting periods. As according to the taxation laws currently applicable in Estonia, it is dividends and not the profits that are subject to taxation, then the entities registered in Estonia have no deferred income tax liabilities. (IFRS for SMEs 29.25).

44. If an entity has foreign subsidiaries, the deferred income tax assets or liabilities of these subsidiaries shall be recognised in the consolidated financial statements. This guideline does not set out a detailed method to account for deferred tax, as according to the Board the accounting for this area has relevance only for a relatively small number of entities in Estonia. If necessary, the Board recommends the use of the method described in section 29 of IFRS for SMEs.

45. According to the Estonian tax acts, the entities cannot pay out all their available shareholders' equity, but a portion of it will cover the income tax on dividends. No provision for the income tax on dividends shall be recognised before the dividends are declared, but disclosures regarding it shall be made in the notes.

46. Corporate income tax on dividends or other equity reducing payouts shall be recognised as a liability and an expense at the time when dividends or other equity reducing payouts are declared. Corporate income tax on dividends shall be accounted for as income tax expense in the income statement in the same period as when dividends are declared, regardless of the period for which the dividends are declared or their actual payment date. (IFRS for SMEs 29.25).

47. In case an entity is required to withhold an additional income tax on dividend in addition to corporate income tax (e.g., on dividend distributed to foreign shareholders), it shall be recognised as a deduction from retained earnings. (IFRS for SMEs 29.26).

Example 8 – Recognition of income tax on dividends

At 30.04.20X1, an entity declares dividends in the amount of 100,000 euros for the year 20X0. Upon the payment of dividends, the entity shall pay income tax on dividends in the amount of 25,000 euros (calculated with the tax rate of 20/80 of the paid out dividend). Additionally, the entity shall withhold income tax in the amount of 5,000 euros on dividends to be paid to a foreign shareholder. The actual payment of dividends is scheduled to take place during 20X1.

The income tax liability and expenses relating to dividends shall be recognised at the time of declaring dividends (30.04.20X1):

D	Retained earnings	100,000	
D	Income tax expense	25,000	
C	Dividend payable	100,000	
C	Income tax liability	25,000	

Before the payment of dividend on 31.07.20X1, the entity collected dividend of its subsidiary in the amount of 10,000 euros, on which the subsidiary paid income tax in the amount of 3,500 euros. Under the legislation in force, upon the payment of its own dividends, the entity can deduct the income tax on dividends received from the income tax payable. Upon the receipt of dividends on 31.07.20X1, the following entry shall be made regarding income tax:

D	Income tax liability	3,500	
C	Income tax expense	3,500	

Example 9 – recognition of income tax on share capital reduction

An entity has total share capital of 1 million euros, which at 30.05.20X1 it is decided to reduce to 100,000 euros by paying out 900,000 euros to shareholders. Shareholders' total contribution to share capital (cost of the ownership interest) is 200 000 euros. Therefore, the entity must pay income tax on the amount of 700,000 euros (the tax rate is 20% (20/80)).

The income tax liability and expense related to the share capital reduction shall be recorded at the date that the share capital reduction is announced (30.05.20X1):

D	Share capital	900,000	
D	Income tax expense	175,000	
C	Payable to shareholders	900,000	
C	Income tax liability	175,000	

CONTINGENT LIABILITIES

48. A contingent liability is a possible or present obligation whose settlement is not probable or whose amount cannot be measured with sufficient reliability. (IFRS for SMEs 2.40, 21.12) Examples of contingent liabilities are:

- (a) a potential expenditure arising from legal proceedings taken against an entity, that the entity is not expected to lose;
- (b) a loan of another entity secured by an entity, that is not expected to lead to any expenditures as the other entity is able to meet its own obligations.

49. *Contingent liabilities shall not be recognised in the balance sheet of an entity, but disclosures on material contingent liabilities are made in the notes to the financial statements. Such contingent liabilities need not be disclosed in the notes whose settlement is most unlikely. (IFRS for SMEs 21.12, 21.15).*

Example 10 – Determining the expected settlement of a contingent liability

<i>Certain realisation</i>	100%	Liability	<i>Record on the balance sheet</i>
<i>Probable</i>		Provision	<i>Record on the balance sheet and describe in notes</i>
<i>Less than likely</i>	50%	Contingent Liability	<i>Describe in notes</i>
<i>Unlikely</i>	0%	-	<i>Don't do anything</i>

CONTINGENT ASSETS

50. Contingent asset is a possible asset 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. (IFRS for SMEs Glossary of Terms).

51. *Contingent assets are not recognised in the entity's balance sheet. Information on such contingent assets, whose economic benefit is likely, is disclosed in the notes to the financial statements. Such contingent assets need not be disclosed in the notes, whose economic benefit is unlikely. Asset, from which the flow of future economic benefits to the entity is virtually certain, is not classified as contingent asset and such asset is accounted for as an asset in the entity's balance sheet. (IFRS for SMEs 21.13, 21.16).*

Example 11 – Example about contingent assets

Contingent asset may be a claim filed against the other entity in litigation proceedings. Its recognition in the entity's balance sheet or notes to the financial statement depends on the probabilistic opinion given to the outcome of the litigation.

Example 12 – Determining the expected settlement of a contingent asset

<i>Certain realisation</i>	100%	Asset	<i>Record on the balance sheet</i>
<i>Probable</i>		Contingent Asset	<i>Describe in notes</i>
<i>Less than likely</i>	50%	-	<i>Don't do anything</i>
<i>Unlikely</i>	0%	-	<i>Don't do anything</i>

COMPARISON WITH IFRS FOR SMES

52. The definitions and accounting policies for provisions, contingent liabilities and contingent assets prescribed in ASBG 8 are in compliance with the accounting policies prescribed in section 21 of IFRS for SMEs.

53. Unlike section 28 of IFRS for SMEs, the guideline ASBG 8 does not provide a detailed description of the accounting of pension provisions and other post-employment benefits as according to the opinion of the Board, the accounting for this area is significant only for a relatively small number of entities in Estonia.

54. Unlike section 29 of IFRS for SMEs, the guideline ASBG 8 does not provide a detailed description of deferred tax assets and liabilities accounting as according to the opinion of the Board, the accounting for this area is significant only for a relatively small number of entities in Estonia.