

ASBG 1 GENERAL PRINCIPLES FOR PREPARING THE FINANCIAL STATEMENTS

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OBJECTIVE AND BASIS FOR PREPARATION

1. The objective of this Accounting Standards Board's guideline ASBG 1 "General Principles for Preparing the Financial Statements" is to explain the concepts and basic principles defined in the Accounting Act as well as to prescribe the rules for applying accounting policies and accounting estimates, correcting errors and presenting events after the reporting date 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 1 is based on IFRS for SMEs sections 2 "*Concepts and Pervasive Principles*", 3 "*Financial Statement Presentation*" 8 "*Notes to the Financial Statements*", 10 "*Accounting Policies, Estimates and Errors*", 22 "*Liabilities and Equity*", 30 "*Foreign Currency Translation*" and 32 "*Events after the End of the Accounting Period*". The guideline of the Standards Board contains references to the specific paragraphs of IFRS for SMEs that the requirements of the guideline are based on¹. The comparison of ASBG 1 with IFRS for SMEs is presented in clauses 103-107. Upon initial implementation of the Estonian financial reporting standard and in areas where ASBG 1 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. ***Entities² preparing the financial statements based on the Estonian financial reporting standard, implement the guidelines of the Accounting Standards Board.***

OBJECTIVE OF THE FINANCIAL STATEMENTS

4. ***The objective of preparing and disclosing the financial statements is to provide the user of the statement with sufficient financial knowledge to understand the statement, relevant and truthfully presented information on the financial position, performance and cash flows of the accounting entity, which the user of the statement could use in making its economic decisions. The financial statement (except for the abridged financial statements of a micro-entity, described in ASBG 2, paragraph 7) must give a fair overview of the financial condition, performance and cash flows of the accounting entity. (IFRS for SMEs 2.2, 3.2).***

¹ For example, the reference to 2.9 of IFRS for SMEs refers to paragraph 9 of section 2 of IFRS for SMEs.

² The guidelines of the Accounting Standards Board consider as an entity the accounting entity within the meaning of Section 2 of the Accounting Act.

5. Financial statements shall present fairly the financial position, financial performance and cash flows of an accounting entity, if it discloses relevant and truthfully presented information. Information is relevant and truthfully presented, if inter alia, it is:
 - (a) accurate and comprehensive in those accounting aspects whose objective is to record economic events;
 - (b) based on deliberate and reasonable estimates in those accounting aspects that require making estimates;
 - (c) the basic principles defined in Section 16 of the Accounting Act and in clauses 33-64 of this guideline have been used as the basis for the preparation of the same;
 - (d) the terms and definitions of assets, liabilities, equity, income and expenses defined in Section 3 of the Accounting Act and described in this guideline have been used as the basis for the preparation of the same; and
 - (e) the financial statements are prepared in proportion to the size of the accounting entity and with such a detail that they provide such an overview of the financial position, performance and cash flows of an entity enabling competent readers to draw reasonable conclusions.

6. According to the Accounting Act, the amount of mandatory information to be presented in the financial statements depends on the size of the entity. As it has been specified in more detail in clause 6 of ASBG 2 and clause 4 of ASBG 15, a micro- and small entities do not have to prepare full financial statements, but instead, may prepare abridged financial statements. Due to low public interest, the amount of mandatory information to be published in the abridged financial statements of a micro entity is very limited, which is why these as a whole might not give a fair overview of the financial position, performance and cash flows of the micro entity.

7. Irrespective of the size of the entity, all entities must proceed from the main principles and accounting policies described in the guidelines of the Standards Board, except for the fact that micro entities preparing the abridged financial statements, described in clause 6 of ASBG 2, may not use the fair value model when accounting for their assets and liabilities. Given a situation, where the guidelines of the Standards Board permit or require using the fair value model (e.g. for financial assets listed in clause 11 of ASBG 3, for investment properties listed in clause 14 of ASBG 6 or for biological assets, specified in clause 12 of ASBG 7), the micro entity, preparing abridged financial statements, must use the cost method or amortised cost method for reporting the respective assets and liabilities. Micro entities may prepare instead of the abridged financial statements of the micro entity either the abridged financial statements of a small entity or a full-scale financial statement, in which case, they are allowed (similarly with other entities) to use all the alternatives in accounting for assets and liabilities permitted in the guidelines of the Standards Board.

8. The correct implementation of all Standard Board guidelines for the preparation of the financial statements normally provides a fair view of the financial position, performance and cash flows of the accounting entity. In extremely rare circumstances in which the management of an accounting entity believes that compliance with certain provisions of the Standard Board guideline does not render it possible to present a fair view of the financial position, performance or cash flows of an entity, the management shall prepare financial statements on the basis of the requirement of fair presentation and shall explain the reasons for non-compliance with the provisions

of the Standard Board's guideline in the notes to the financial statements. (IFRS for SMEs 3.4, 3.5).

KEY DEFINITIONS

9. Assets, liabilities, equity, income, expenses and profit presented in financial statements shall meet the definitions provided in Section 3 of the Accounting Act. The meanings of these key concepts are explained in clauses 9-32 of this guideline, based on section 2 of IFRS for SMEs, "*Concepts and Pervasive Principles*".
10. ***Asset is a resource under the control³ of an accounting entity, which:***
 - (a) *has occurred as a result of past events and*
 - (b) *is estimated to bring economic benefits in the future (participates in the realisation of set targets for non-profit accounting entities). (IFRS for SMEs 2.15).*
11. An asset may, but need not, have physical substance. An asset may be for example a tangible item, activity license or contractual right. (IFRS for SMEs 2.18).
12. The reporting of assets on the balance sheet shall be determined on the basis of control and not merely on legal ownership. Although control of assets normally coincides with their legal ownership, this may not always be the case. For example, in the case of finance lease agreements, an asset may legally belong to a lessor, but as it is in the possession of a lessee for the most part of its useful life, it is reported on the lessee's balance sheet.
13. In identifying control, of significant importance is the fact who will receive most of the economic benefits arising from the asset and who will assume most of the risks relating to an asset.
14. An ability to generate economic benefits means an ability to increase the inflows of cash and cash equivalents to the entity or reduce the outflows of cash and cash equivalents from the entity. (IFRS for SMEs 2.17).
15. An asset is recorded on the balance sheet of an accounting entity only if it is probable that it will participate in the generation of future economic benefits (in the attainment of goals set for non-profit accounting entities). If a certain asset may participate in the generation of economic benefits or attainment of other goals but there is insufficient certainty that this is the case, then it shall be reported off-balance sheet as a contingent asset. (IFRS for SMEs 2.16).
16. Only such assets are recognised on the balance sheet whose cost or any other value used as a basis for reporting it on the balance sheet can be determined reliably. (IFRS for SMEs 2.27, 2.30).

³ The word "control" previously used in the Standard Board's guidelines, has been replaced with the word "dominant influence", pursuant to the definition of an asset in the Accounting Act. Within the context of the Standard Board's guidelines, these are synonyms.

- 17. Liability⁴ is the 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).
- 18.** A liability is recognised on the balance sheet if as a result of it an entity is forced to act in a way that presumably requires it to give up resources embodying future economic benefits. For settling a liability, an entity may, for example, be forced to pay in cash or cash approximations, provide a certain service or give up a certain asset. (IFRS for SMEs 2.16, 2.21).
- 19.** Most liabilities arise from legal agreements (so-called legal obligation). In certain cases liabilities may also arise from the entity's expected business practice and a desire to maintain good business relations with its customers, employees, creditors and other business partners (so-called factual obligations). For example, if the business practice of an entity calls for a replacement of all defective products for free during a certain period, the entity shall recognise this factual obligation arising from such a business practice on its balance sheet as a liability, regardless of whether it has a legal obligation or not. (IFRS for SMEs 2.20).
- 20.** Only such liabilities are recognised on the balance sheet whose settlement amount can be measured reliably. (IFRS for SMEs 2.27, 2.30).
- 21. Equity (net assets) is the residual holding in the assets of an accounting entity after the deduction of all of its liabilities. (IFRS for SMEs 2.15).**
- 22.** Equity represents net assets belonging to the shareholders of an entity as of the reporting date. The calculation of equity depends on the accounting policies used for measuring assets and liabilities, some of which are based on fair value, others on cost or another method. Nor does equity include internally generated goodwill. As a result, the net assets of an entity do not generally equal the market value of the entity.
- 23.** An overview of an entity's assets, liabilities and equity is provided in the balance sheet of an accounting entity as of the reporting date.
- 24. Income is defined as increases in economic benefits during the accounting period in the form of inflows or enhancements of assets or decreases of liabilities that result in increases in equity, other than those relating to contributions from equity participants. (IFRS for SMEs 2.23).**
- 25. Expenses is a reduction in economic benefits during the accounting period through a reduction, exhaustion or depreciation of assets or generation of liabilities, as of a result of which the owners' equity decreases, excluding payments made to the owners on account of the equity. (IFRS for SMEs 2.23).**
- 26.** The main characteristic of income is the fact that it increases the net assets of an entity without additional contributions made by the shareholders of an entity. The main

⁴ The word "obligation" previously used in the Standard Board's guidelines, has been replaced with the word "liability", pursuant to the definition in the Accounting Act. IFRS for SMEs differentiates the terms *obligation* and *liability*.

characteristic of expenses is the fact that they decrease the net assets of an entity without any distributions made to the shareholders of the entity. Both income and expenses are accounted for by the accrual method of accounting – that is at the time when the effect of an economic transaction on the net assets of an entity actually occurs, and not at the time when the cash flows related to the transactions occur. (IFRS for SMEs 2.36).

27. Expenses are recognised in the same period as income incidental to them (see clauses 53-54 – the matching principle). Costs expected to be incidental to the generation of economic benefits in the following accounting periods are recognised as assets when they are incurred and as expenses in the accounting period(s) when they are expected to generate economic benefits (for example, expenditure on property, plant and equipment). Costs that are incidental to the generation of economic benefits in the accounting period or those that are not incidental to the generation of economic benefits are recognised as an expense in the accounting period when they are incurred.
28. Income and expenses include both realised as well as unrealised income and expenses. For example, realised income is revenue recognised upon the sale of goods. Unrealised income is income recognised upon the revaluation of investments to their fair values.
29. Most of the income and expenses of the accounting period are recognised in the income statement of the accounting period. Exceptions are certain unrealised gains and losses that pursuant to IFRS for SMEs and Standard Board's guidelines are accounted for in the statement of comprehensive income instead of the income statement (see examples in clause 31 of ASBG 2).
30. Transactions with an entity's treasury shares represent distributions made to the owners of an entity or contributions received from the owners of an entity, as a result of which they do not fall under the definition of income and expenses. Therefore, such transactions shall neither be recorded as income nor expenses in the income statement, but as an equity transaction in the statement of changes in equity. (IFRS for SMEs 22.16).
31. ***Profit (loss) is the difference between the income and expenses of an accounting entity during an accounting period. (IFRS for SMEs 2.23).***
32. For example, a profit (a loss) from changes in foreign exchange rates is the difference between income and expenses relating to foreign exchange rates. An operating profit (operating loss) of an entity is the difference between income and expenses arising from business operations. The difference between all income and expenses of the accounting period (except for profit and loss mentioned in clause 29 that are recorded in the statement of comprehensive income) is called the net profit (loss) of the accounting period or profit (loss) of the accounting period.

BASIC PRINCIPLES FOR PREPARING THE FINANCIAL STATEMENTS

33. Section 16 of the Accounting Act defines basic principles serving as a part of the internationally accepted accounting and reporting principles, which must be taken as basis when preparing the financial statements. Clauses 34-62 explain the contents of these basic principles further.

Economic Entity Principle

- 34. *The accounting entity shall keep accounts of its own assets, liabilities and business transactions separately from the assets, liabilities and economic transactions of its shareholders, creditors, employees, customers and other persons.***
- 35.** Only the assets, liabilities, equity, income, expenses and cash flows of an accounting entity shall be recorded in the financial statement. The financial statements of a consolidation group (hereinafter also *consolidated financial statement*) shall include in addition to the business transactions of the accounting entity itself also those of the entities over⁵ which it has control.

Going Concern Principle

- 36. *The financial statement is prepared under the assumption that an accounting entity is a going concern and it has neither the intention nor the need to terminate its activities. When the financial statements are not prepared on a going concern basis, it shall disclose in the financial statement the basis on which it prepared the financial statements. (IFRS for SMEs 3.8, 3.9).***
- 37.** In preparing the financial statements, the management is required to assess the entity's ability to continue as a going concern at least in a 12-month perspective from the reporting date. If there is uncertainty as to the going concern of the entity (e.g., the entity's equity does not meet the requirements of the Commercial Code), the management is required to disclose the circumstances causing this uncertainty in the notes to the financial statements. If an entity has started to terminate its operations or it is probable that it will start or is forced to terminate its operations within the next 12 months, the financial statement shall be prepared in accordance with ASBG 13 "Liquidation and Final Reports" that regulates the reporting of the entities to be liquidated.

Understandability Principle

- 38. *Disclosures in the financial statement shall be presented in an informative and unambiguous manner to the users of financial statements who have adequate knowledge of finance to understand the financial statement. (IFRS for SMEs 2.4).***
- 39.** Financial statement is prepared to inform a wide range of users of these statements (incl. entity's owners and creditors, employees, business partners, the general public, state institutions). Consistent terminology is used for the sake of informativeness and understandability throughout the financial statements. In preparing the financial statement, it should be kept in mind that they be also easily legible and understandable to external users who may not be familiar with the day-to-day activities of the entity. As a result, the financial statements shall be prepared so that they avoid entity-specific use of language that may not be understandable to external readers. However, when preparing the financial statement, readers of the statement are expected to have

⁵ The word "control" previously used in the Standard Board's guidelines, has been replaced with the word "dominant influence", pursuant to the definition of a consolidation group in the Accounting Act. Within the context of the Standard Board's guidelines, these are synonyms.

sufficient general knowledge of accounting and financial accounting, therefore, general financial concepts need not be explained in the financial statement.

40. If the disclosures regarding related information are made in separate parts of the financial statement, these parts of the financial statement shall be cross-referenced. For example, references to the items of the balance sheet, income statement and statement of cash flows are added to the notes which disclose more detailed information for these items. If information on one and the same transaction or financial information is disclosed in two separate notes, such notes shall be cross-referenced.

Materiality Principle

41. *Financial statements shall set out all material information which affects the financial position, performance and cash flows of the accounting entity. Information in financial statements is considered material if failure to disclose the information could influence the business decisions made by the users of the statements on the basis thereof. Immaterial items may be accounted for and recorded in the financial statements using a simplified method. (IFRS for SMEs 2.5, 2.6, 3.15, 3.16).*
42. In preparing the financial statement, emphasis should be laid on those aspects of the entity's activities and financial data that are material to the users of the financial statements and that may affect the business decisions made by them. (IFRS for SMEs 2.5) Excessive details and irrelevant information in the financial statement impairs the legibility and understandability of the statement.
43. In assessing materiality, both the size of the amount as well as the nature of information shall be considered. In case of certain transactions (for example, related party transactions), considerably smaller amounts may turn out to be more material for users than in case of other, regular transactions. Intentional manipulation of immaterial amounts to achieve a certain financial result is prohibited. (IFRS for SMEs 3.16).
44. Simplified accounting methods may be used for accounting for and reporting immaterial items in the financial statements, assuming that the result will not significantly differ from the results obtained through the application of the accounting policies generally required in the guidelines of the Standards Board.
45. Disclosures of individually material items and transactions shall be made separately (IFRS for SMEs 3.15). Immaterial items may be reported as aggregate amounts in the financial statement and grouped appropriately with other immaterial items.
46. Based on the materiality and understandability principles, it might be more appropriate to prepare the financial statements in thousands of euros instead of full euros. This enables to avoid excessive details and focus on more material financial information.

Consistency and Comparability Principle

47. *The same accounting policies and presentation is used on an on-going basis in preparation of financial statements. (IFRS for SMEs 2.11, 3.11).*

48. Consistency in accounting policies, presentation and financial statement formats is necessary for an objective comparison of an entity's financial data throughout the years. Uniform requirements for accounting policies, presentation formats and disclosures in the financial statements provide a basis for comparing the financial data of different entities. (IFRS for SMEs 2.11).
49. Changes in accounting policies are addressed in clauses 69-73 of this guideline.
50. The presentation format of information (incl. the forms of the balance sheet, income statement, cash flow statement and statement of changes in equity) may be amended only if (IFRS for SMEs 3.11):
- (a) the change has been brought about by a new or revised guideline of the Standards Board, the Accounting Act or IFRS for SMEs; or
 - (b) the new presentation format enables a more objective presentation of the financial position, performance and cash flows of an accounting entity (e.g., if the entity has changed its area of operations and as a result of this, changes in presentation have become appropriate).
51. Comparative information of the previous period shall be included in the financial data of the accounting period disclosed in the financial statement, unless the guideline ASBG 15 "Disclosures in the Notes" permits non-disclosure of comparative information. (IFRS for SMEs 3.14).
52. When presentation of information is changed, comparative information of the previous period presented in the financial statements shall also be restated to correspond to new presentation except when the effect of new presentation on the previous periods cannot be determined reliably. (IFRS for SMEs 3.12).

Matching Principle

53. *Costs associated with income earned during an accounting period are deducted from such income. Expenditures, the corresponding income of which is generated in a different period, are recognised as expenses in the period with income generated in relation to the same. (IFRS for SMEs 2.41, 2.42, 2.36).*
54. Expenses are recognised in the same period as the associated income. If income associated with certain expenses cannot be directly identified, then indirect methods shall be used for the recognition of expenses. For example, expenditure relating to the acquisition of an item of property, plant and equipment are recognised as an expense during the useful life of this item (as a depreciation charge). Expenditure not expected to generate income is recognised as an expense at the time when it is incurred.

Objectivity Principle

55. *The information presented in the financial statement shall be neutral and reliable. (IFRS for SMEs 2.7, 10.4 (b)(i),(iii))*
56. In preparing the financial statement and making accounting estimates, the management shall consider all the information available to them, incl. events coming

to the management's attention after the reporting date but prior to approving the financial statement. The choice and presentation of disclosures shall be objective and neutral; bias shall be avoided when preparing the financial statement and equal attention shall be paid both to negative and positive disclosures.

Prudence Principle

57. *Financial statement shall be prepared on a prudent and cautious basis in order to avoid overestimation of assets and income or underestimation of liabilities and expenses. At the same time, deliberate underestimation of assets and income or deliberate overestimation of liabilities and expenses as well as the creation of reserves hidden from the users of the financial statement is not justified. (IFRS for SMEs 2.9, 10.4(b)(iv)).*

58. In making accounting estimates, the management shall avoid excessive optimism and shall consider all circumstances that might affect the carrying amount of assets and liabilities. For example, upon writing down doubtful receivables, the management shall consider previous experience with uncollectible receivables and not optimistically assume that the situation has likely improved and this time there is no need for a write-down.

Disclosure Principle

59. *Financial statements shall set out all the information which provides the users of the statement who have sufficient financial knowledge to understand the statement with an opportunity to obtain relevant and truthfully submitted financial information regarding an accounting entity. (IFRS for SMEs 2.10, 10.4(b)(v))*

60. A complete overview of an entity's financial position, performance and cash flows as well as other relevant circumstances that affected the entity's financial data in the accounting period or are expected to affect them over the next periods is disclosed in the financial statements. Information relevant to the users of the financial statements is disclosed even if it is not specifically required by any guideline of the Standards Board.

Substance over Form Principle

61. *Business transactions are recorded in accounts and financial statements based on their substance even if this does not correspond to their legal form. (IFRS for SMEs 2.8, 10.4(b)(ii))*

62. In recording business transactions, their substance is of utmost importance rather than how they have been legally formalised. Although in most cases the substance of business transactions corresponds to their legal form, this may not always be the case. For example, certain lease agreements may formally be called operating lease agreements, but if they meet the criteria for a finance lease described in the guideline ASBG 9 "Accounting for Leases", they are recognised as finance leases for accounting purposes and in the financial statements.

Example 1 – substance over form

An entity enters into a securities repurchase agreement with the bank. According to the terms of the repurchase agreement, the entity sells a certain number of securities to the bank and also undertakes to repurchase them at the agreed upon time and price. Although the entity has formally sold the securities to the bank and the bank also legally owns them until the repurchase date, the substance of the transaction is the loan with securities as collateral, and not the purchase and sale of securities.

Based on the substance of the transaction, the “sold” securities are not taken off the entity’s balance sheet (despite the fact that they legally belong to the bank), but the transaction is recorded as a loan with securities as collateral.

Balance between costs incurred on and benefits obtained from information collected

63. *The benefit to users of financial statements from information collected for preparation of the financial statements must exceed the costs incurred on collecting the information. (IFRS for SMEs 2.13).*

64. Some guidelines of the Standards Board allow using certain simplified methods in case information cannot be collected without undue cost or effort. In its evaluation of due cost and effort, management must consider how the existence or absence of information may impact the business decisions made by users of the financial statements. Information cannot be collected without undue cost or effort if the resulting expenses (for example, fees paid to external experts) or amount of work performed by the entity's employees are proportionally too great compared to the benefit that users of the financial statements would obtain from having this information.

APPLICABLE ACCOUNTING POLICIES AND CHANGES IN ACCOUNTING POLICIES

Selection of Accounting Policies

65. *The accounting policies and presentation format used in the financial statements prepared in accordance with the Estonian financial reporting standard shall be in compliance with the requirements (incl. basic principles) provided for in the Accounting Act and the guidelines of the Standards Board.*

66. In areas in which the guidelines of the Standards Board allow choosing between several alternative accounting policies (e.g., the FIFO and weighted average cost method for accounting for inventories), the accounting policies applied shall be disclosed in the notes to the financial statements.

67. In areas where the guidelines of the Standards Board do not specify a specific accounting policy but that are regulated by IFRS for SMEs (e.g., accounting for hedging instruments), it is recommended to use the accounting policy described in IFRS for SMEs as the basis.

68. In specific areas of economic activity and in extremely rare circumstances, where it is not possible based on the guidelines of the Board or the IFRS for SMEs, to present the information in a relevant and truthful manner, the accounting entity shall establish suitable accounting policies itself, proceeding from (IFRS for SMEs 10.4-10.6):
- (a) Board's guidelines and sections of IFRS for SMEs that regulate similar accounting areas;
 - (b) generally accepted financial reporting standards to the extent that these are not in conflict with the current legislation of Estonia;
 - (c) definition of assets, liabilities, equity, income and expenses;
 - (d) international practice in the area.

Change in Accounting Policies

69. *An accounting policy once chosen shall be applied consistently year after year. An accounting policy can be changed only in the following cases (IFRS for SMEs 10.7, 10.8):*
- (a) the change in the accounting policy has been brought about by a new or revised guideline of the Board, the Accounting Act or IFRS for SMEs; or*
 - (b) if the new accounting policy enables a more objective presentation of the financial position and performance and cash flows of an accounting entity (while complying with the requirements set out in clause 66).*
70. *The effect of a change in the accounting policy is applied retrospectively unless (IFRS for SMEs 10.11, 10.12):*
- (a) a change to the accounting policy has resulted from a new guideline of the Board, the Accounting Act or a change in IFRS for SMEs and different rules for the transition to the new method have been prescribed in it; or*
 - (b) the effect of the change in the accounting policy on previous periods cannot be determined reliably.*
71. An effect of the change to accounting policies is generally recognised retrospectively, i.e. as if the new method had always been in use. Comparative information from the previous period is restated so that it is in compliance with the new accounting policy. The opening balance of retained earnings is adjusted by the effects to the previous or even earlier periods.
72. As an exception, certain Board guidelines (or IFRS for SMEs) may establish prospective application of a new accounting policy without the adjustment of comparative information. The application provisions described in those guidelines shall be used as the basis for the application of such guidelines. (IFRS for SMEs 10.11 (a)).
73. If it is impracticable to reliably determine the effect of a change to an accounting policy on comparative information of the prior period (incl. on the opening balances of the prior period), the new accounting policy shall be applied retrospectively from the beginning of the accounting period (recognising the effect from prior periods as an adjustment to the opening balance of retained earnings). Also, if it is impracticable to reliably determine the cumulative effect of a change to an accounting policy also on the opening balances of the accounting period, a new accounting policy shall be applied prospectively from the earliest date practicable. (IFRS for SMEs 10.12).

Example 2 – change of accounting policy

Due to the entry into force of the new guideline of the Board, associates may be recognised in consolidated financial statements using the cost method from 01.01.20X1. Instead of the equity method that has been used so far, the entity shall recognise associates using the cost method.

As the guideline on the change of the accounting policy lacks special provisions for the application of the new method, the change to the accounting policy shall be applied retrospectively. This means that the comparative data for 20X1 presented in the financial statements for 20X0 (investments in associates and retained earnings on the balance sheet, profits/losses from associates in the income statement) shall be adjusted as if the associates had always been accounted for using the cost method.

The balance of retained earnings in the statement of changes in equity shall be adjusted by the effect extending to the accounting period before the previous and earlier periods as at the opening balance date of the earliest accounting period (01.01.20X0) presented in the financial statements.

Due to the adjustment, comparative information of 20X0 presented in the financial statements of 20X1 shall differ from the information presented in the financial statements of 20X0. A change in accounting policy and opening balance adjustments must be explained in the notes.

ACCOUNTING ESTIMATES AND CHANGES THEREIN

Application of Accounting Estimates

74. Several financial figures presented in the financial statement are based on management's estimates and not on unambiguously measured data (IFRS for SMEs 2.30). Examples of the application of accounting estimates are:
- (a) estimation of the allowance for receivables and inventories;
 - (b) estimation of the useful lives of property, plant and equipment and intangible assets and determination of depreciation rates;
 - (c) estimation of the value of assets using the fair value method;
 - (d) establishment of a provision for a warranty obligation or for covering the costs relating to a pending lawsuit.
75. Realistic estimates play an important role in the preparation of reliable financial statements. In making accounting estimates, the entity's management is required to consider all facts known to them that could affect the information reported in the statements as a result of the estimate. For example, in recognising a provision to cover the possible costs relating to a pending lawsuit, management is required to consider all facts relating to the lawsuit (including those that became evident after the reporting date) that could affect its course and the related costs.
76. Although it is to be expected that some accounting estimates will turn out to be inaccurate, management is required to make estimates to the best of their knowledge.

When new facts become evident, previously made estimates shall be changed if necessary.

Changes in Accounting Estimates

77. Changes in accounting estimates shall be recognised during the period in which the change occurred (or if needed, during future periods – for example, the depreciation charge), not retrospectively. (IFRS for SMEs 10.16, 10.17).

Example 3 – Recording the changes in accounting estimates in determining depreciation

An entity's balance sheet includes production equipment with the cost of 100 000 euros, whose useful life was initially estimated at 20 years (depreciation of 5000 euros annually). After the first five years of use (carrying value of equipment 75 000 euros) upon evaluating the technical condition of the equipment and considering the innovations taking place in the marketplace, it was concluded that the estimated remaining useful life of the equipment is 10 years.

At the time when the change occurs in the accounting estimate (i.e. regarding the remaining life of the equipment), the depreciation rates shall be changed so that the carrying value of the equipment is depreciated over 10 years (depreciation of 7500 euros annually).

Since it is the estimates and not the accounting policies that were changed, then the depreciation expense of the prior periods will not be adjusted.

Example 4 – Recording the changes in accounting estimates in management's estimates

As at 31.12.20X1 an entity has a pending lawsuit. When consulting with the lawyers, it becomes evident that the costs relating to the lawsuit will be in the range of 1-2 million euros. The management sets up a provision in the amount of 1.5 million euros:

D Provisions expense	1.5
C Provision	1.5

As at 31.12.20X2, the lawsuit is still pending, but by the time of preparing the financial statements it has become evident that the actual cost would be 1 million euros. The accounting entry upon the preparation of the 20X2 financial statements:

D Provision	0.5
C Provisions expense	0.5

As the management's estimate has changed, then comparative information for the prior period will not be adjusted, despite the fact that the estimate on the provision turned out to be inaccurate.

78. Under certain circumstances it might be difficult to distinguish whether it is a change in accounting policy or a change in accounting estimates. In such cases it is assumed that this is a change in accounting estimates and the effect of the change is recognised in the accounting period (or prospectively), not retrospectively. (IFRS for SMEs 10.15).

CORRECTION OF ERRORS

79. *Errors are omissions from and misstatements in the entity's financial statements for one or more prior periods, arising from a failure to use or misuse of information that was available for management during the preparation of those financial statements. (IFRS for SMEs 10.19).*
80. The reason of the error may include erring against the calculation rules, improper implementation of accounting policies, fraud, concealment or ignorance of information. (IFRS for SMEs 10.20).
81. Errors differ from changes in accounting estimates. Changes in accounting estimates are based on adequate and reliable information and its change over time, and not on its incorrect use. An error is characterised by the fact that although the management had adequate and reliable information to prepare accurate statements at the time of preparing the financial statements, this information was not used or it was used incorrectly.
82. *Material prior period errors shall be corrected retrospectively, except if the effect of the error on prior periods cannot be determined reliably. (IFRS for SMEs 10.21).*
83. The materiality concept is described in clauses 41-46 of this guideline.
84. Material prior period errors are generally corrected retrospectively, i.e. as if the error had never occurred. Comparative information for the prior period is restated by the effect of the error. If an error was made in the accounting period before the last one or even in an earlier period, the prior period's opening balances of assets, liabilities and retained earnings shall be corrected by the effect of the error.
85. If the effect of a material error on comparative information for the prior period (incl. on the opening balances of prior periods) cannot be determined reliably, the opening balances of assets, liabilities and retained earnings of the accounting period shall be corrected by the effect of the error occurring in prior periods. When it is impracticable to reliably determine the cumulative effect of the error on the opening balances of the accounting period, the error shall be corrected prospectively from the earliest date practicable. (IFRS for SMEs 10.22).

Example 5 – Recording an immaterial error

An entity's management discovers after the approving of the 20X1 financial statement that before the end of the year, goods worth 1,000 euros had been stolen from the warehouse. This theft was not reported in the 20X1 financial statement. Since this is an immaterial error from the point of view of financial statement, comparative information for 20X1 will not be changed retrospectively in the 20X2 financial statements, but the effect of the theft is recognised as an expense for 20X2.

Example 6 – Recording a material error

In the autumn of 20X1 it becomes evident that a member of the management had secretly signed an agreement that caused a 1.2 million euro loss to the entity. The other members of the management as well as the auditor were unaware of the agreement and hence its effect was not reported in the 20X1 financial statement. Since it was a material error from the point of view of this entity, comparative information for 20X1 will be corrected retrospectively in the 20X2 financial statements and the reasons for the correction will be explained in the notes.

FUNCTIONAL CURRENCY, PRESENTATION CURRENCY AND RECOGNITION OF FOREIGN CURRENCY TRANSACTIONS

Functional Currency of Transactions and Presentation Currency of the Financial Statement

- 86.** Functional currency of transactions is the currency for keeping current records of all business transactions (all other currencies are considered as foreign currencies for this particular entity). (IFRS for SMEs 30.2) The currency of an entity's primary economic environment shall be selected as its functional currency, i.e. a currency that affects an entity's receipts and disbursements the most. The following aspects shall mainly be considered in determining the currency of an entity's primary economic environment (IFRS for SMEs 30.3):
- (a) which currency affects an entity's selling prices the most (incl. which country's market situation and legal environment affect an entity's selling prices the most); and
 - (b) which currency affects an entity's main expenditures (labour, materials, etc.).
- 87.** In case the criteria listed in clause 86 do not provide sufficient clarification for determining the currency of an entity's primary economic environment, additional criteria such as in which currency the entity normally borrows funds to finance its activities and in which currency it keeps receipts received from its operations should be considered. (IFRS for SMEs 30.4) ASBG 11 "Business combination and Accounting for Subsidiaries and Associates" lists additional criteria for determining a subsidiary's functional currency.
- 88.** The presentation currency of the financial statements is the currency in which an entity presents its financial statements. (IFRS for SMEs 30.17).
- 89.** According to subsection 15 (5) of the Accounting Act, financial statements shall be prepared in the currency officially applicable in Estonia. Thus, the presentation currency of financial statements prepared pursuant to the Accounting Act is the official currency of Estonia. Economic transactions of companies in Estonia are generally conducted in the official currency of Estonia (functional currency), as the use of this currency enables the most objective reflection of the risks related to the economic environment of Estonia.

90. In very rare circumstances, the selection of a functional currency (i.e. keeping current records of an entity in another currency) other than the official currency of Estonia may be appropriate. The selection of a functional currency other than the official currency of Estonia can be justified if the majority of the entity's transactions (incl. transactions generating both revenues and expenses) occur outside the Estonian economic environment and are denominated in a foreign currency.
91. If, pursuant to clause 90, the currency for keeping current records is a currency other than the official currency of Estonia, the following method shall be used for the translation of financial data in a foreign currency (functional currency) to the official currency of Estonia (presentation currency) for preparing the financial statement (IFRS for SMEs 30.18, 30.19):
- (a) assets and liabilities shall be translated at the spot exchange rate of the reporting date;
 - (b) income and expenses shall be translated at the spot exchange rate at the date when they occur (for practical reasons, the weighted average rate for the period may also be used);
 - (c) resulting currency translation differences shall be recognised as other comprehensive income (loss) in the statement of comprehensive income.
92. If an entity that keeps current accounts in the official currency of Estonia, wishes in addition to the financial statements prepared in accordance with the requirements of the Accounting Act also to prepare supplementary statements in another currency (e.g., for presentation to foreign investors), the translation method set out in clause 91 for the translation of financial data from the official currency of Estonia (functional currency) to a foreign currency (presentation currency) shall be used.

Recognition of Foreign Currency Transactions

93. *A foreign currency transaction is a transaction that is denominated or requires settlement in a foreign currency. Foreign currency transactions shall initially be recognised at the spot exchange rate of the official currency of Estonia at the transaction date. (IFRS for SMEs 30.6, 30.7).*
94. *At the reporting date the following items shall be translated using the spot exchange rate:*
- (a) all monetary assets and liabilities denominated in a foreign currency; and*
 - (b) non-monetary assets and liabilities denominated in a foreign currency that are accounted for using the fair value model. (IFRS for SMEs 30.9 (a), (c))*
- Resulting currency translation differences shall be recognised as profit/loss from the exchange rate in the income statement. (IFRS for SMEs 30.10).*
95. Monetary assets and liabilities are cash and such assets and liabilities that are settled in cash at a previously determined amount. Examples of monetary assets and liabilities are:
- (a) cash;
 - (b) receivables (incl. trade receivables, loans given) that are paid for in cash;
 - (c) payables (incl. supplier payables to employees, borrowings, bonds) that are paid for in cash.

96. Examples of non-monetary assets and liabilities that are generally accounted for using the fair value model are investment properties, biological assets as well as short-and long-term financial investments in shares and other equity instruments whose fair value can be estimated reliably. The spot exchange rate at the date of determining fair value is used for the translation of foreign currency non-monetary assets and liabilities accounted for using the fair value model.
97. Such non-monetary assets and liabilities that are not accounted for using the fair value model (for example prepayments, inventories accounted for using the cost method, property, plant and equipment and intangible assets) shall not be translated at the reporting date, but they are accounted for on a continuous basis using the spot exchange rate of the transaction date. (IFRS for SMEs 30.9 (b)).

EVENTS AFTER THE REPORTING DATE

98. The reporting date is the final date of the last accounting period covered by the statement. Accounting period is the period covered by the statement. (IFRS for SMEs Glossary of Terms) Accounting for events occurring after the reporting date but before the date when the financial statements are authorised for issue depends on whether it is an adjusting or a non-adjusting event.
99. *Adjusting event after the reporting date is an event confirming the circumstances existing at the reporting date. (IFRS for SMEs 32.2 (a)) The effect of adjusting events is recorded in the balance sheet and income statement of the accounting period ended. (IFRS for SMEs 32.4).*
100. Examples of adjusting events are (IFRS for SMEs 32.5):
- (a) the sale of inventories after the reporting date at a price lower than their cost, providing evidence of the fact that their net realisable value was already lower than their carrying amount at the reporting date and that inventories should be written down on the balance sheet of the accounting period ended;
 - (b) judicial proceedings initiated against the entity after reporting date in conjunction with the violation of law that occurred before the reporting date. Since the violation of law as the event leading to judicial proceedings occurred before the reporting date, it is an adjusting event and a provision for the costs accompanying the court case will be recognised on the balance sheet for the accounting period ended despite the fact that judicial proceedings were initiated only after the reporting date;
 - (c) judicial proceedings that reached an end after reporting date that were pending as at the reporting date. The provision based on the fine imposed in the judicial decision must be recognised in the balance sheet for the accounting period ended;
 - (d) customer's bankruptcy after the reporting date if it indicates that the receivable against such customer has impairment characteristics already as at the reporting date. The receivable must be written down in the balance sheet for the accounting period ended.
101. *Non-adjusting event after the reporting date is an event confirming the circumstances existing at the reporting date. (IFRS for SMEs 32.2 (b)) The effect*

of non-adjusting events shall not be recorded on the balance sheet and income statement for the accounting period ended, but are disclosed in the notes if material. (IFRS for SMEs 32.6, 32.10).

- 102.** Examples of non-adjusting events are (IFRS for SMEs 32.7, 32.11):
- (a) a fire that occurred after the reporting date as a result of which the production facility was destroyed. Although it is known by the preparation date of the financial statements that the facility was destroyed, it is not written down in the financial statements for the year ended, but the effect of the fire shall be disclosed in the notes.
 - (b) judicial proceedings initiated against the entity after reporting date in conjunction with the violation of law that occurred after the reporting date;
 - (c) a change in the market value of financial investments after the reporting date indicates circumstances occurring after the reporting date, thus the value of financial investments is not adjusted in the financial statements;
 - (d) judicial proceedings that reached an end after the reporting date with which the entity was awarded compensation from another party. Such compensation as at the reporting date corresponds to the definition of a contingent liability (see ASBG 8 “Provisions, Contingent Liabilities and Contingent Assets”) and is thus not recognised on the balance sheet. However, if the receipt of compensation was almost certain at the reporting date but the amount thereof could not be measured reliably, the judicial decision may be an adjusting event that provides additional information on the circumstances in existence as at the reporting date.

COMPARISON WITH IFRS FOR SMES

- 103.** The concepts and basic principles described in ASBG 1 are in accordance with sections 2 and 3 of IFRS for SMEs (IFRS for SMEs does not address the economic entity principle).
- 104.** Accounting for changes in accounting policies and changes in accounting estimates and the correction of material errors complies with section 10 of IFRS for SMEs.
- 105.** The selection of a currency for current transactions, the preparation of the financial statements in a foreign currency and the recording of foreign currency transactions are consistent with section 30 of IFRS for SMEs.
- 106.** The recording of events occurring after the reporting date is consistent with section 32 of IFRS for SMEs.
- 107.** Unlike guidelines of the Board, IFRS for SMEs does not allow preparation of abridged financial statements. The requirement to allow abridged financial statements arises from the European Union accounting directive and the abridged financial statements do not correspond in many respects to the requirements of IFRS for SMEs (incl. in terms of primary statements and their items, information disclosed in notes and also certain accounting policies of micro entity’s abridged financial statements).