Contingent Liabilities (CL) are the common man’s version of ‘saving for a rainy day’ only this rainy day is more predictable and calculated. CL’s are a company’s way of setting money aside for a liability that is predicted to happen to a high degree of certainty (Harrison, 2012). For instance if an automobile manufacture is getting sued due to a defect in their product, that company may establish a CL Account to prepare and account for the financial burden a loss would bring (Investopedia, 2014). This company understands that a recall was not announced and these defects have been shown to cause distress to its customer, therefore increasing the possibility of a judgment against the company. The CL Account will allow the company to set money aside in increments or all at once but it’s on the company’s schedule and prevent them from taking a direct financial hit at the judicial timeline.

CLs come in two variations, explicit and implicit. Explicit CL are contractual based and are awarded to a beneficiary though judgments or to fulfill a contract obligation. Implicit is the moral belief that a company is expected to do the right thing in response to a given situation (Currie, 2002).

The reasons for CLs are to aid the company in dealing with money loss from liabilities. Using CLs are the best way a company can prepare for financial hits and soften the impact to their balance sheets. Depending on the size of the company and cost of liabilities, CLs could have a huge impact to financial decisions. Any money that is set aside for pay outs is preventing from generating a profit on it. Therefore it could slow the inventory turnover which, in turn, reduces sales and profits. However, CLs are a must to soften a financial blow.