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## IASB<sup>®</sup> meeting

Date	<b>April 2024</b>
Project	<b>Second Comprehensive Review of the <i>IFRS for SMEs</i><sup>®</sup> Accounting Standard</b>
Topic	<b>Intragroup issued financial guarantee contracts</b>
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This paper has been prepared for discussion at a public meeting of the International Accounting Standards Board (IASB). This paper does not represent the views of the IASB or any individual IASB member. Any comments in the paper do not purport to set out what would be an acceptable or unacceptable application of IFRS<sup>®</sup> Accounting Standards or the *IFRS for SMEs*<sup>®</sup> Accounting Standard. The IASB's technical decisions are made in public and are reported in the IASB<sup>®</sup> *Update*.

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## Purpose of this paper

1. The purpose of this paper is to ask the International Accounting Standards Board (IASB) to:
  - (a) consider feedback on the proposed requirements in the Exposure Draft *Third edition of the IFRS for SMEs Accounting Standard* (Exposure Draft) for issued financial guarantee contracts; and
  - (b) decide whether to make any changes to the proposed requirements for intragroup issued financial guarantee contracts.
2. Feedback during this comprehensive review provides evidence that financial guarantee contracts issued by SMEs are mostly likely to be intragroup financial guarantees (for example, a parent providing a financial guarantee over its subsidiary's borrowings). Respondents to the Exposure Draft said that measuring the fair value of these financial guarantee contracts can be difficult and recognising and measuring these contracts provides limited information benefits to users of the financial statements. This paper asks the IASB to consider further simplifications for intragroup issued financial guarantee contracts that are issued at a zero-premium.

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3. The staff will ask the IASB, at a future meeting, to discuss the requirements for issued financial guarantee contracts:
    - (a) that are not intragroup contracts; and
    - (b) that are intragroup contracts but are not issued at a zero-premium.
  4. In this paper, the term SMEs refers to entities that are eligible to apply the *IFRS for SMEs Accounting Standard* (the Standard).

### **Staff recommendation**

5. The staff recommend that intragroup financial guarantee contracts that are issued at a zero-premium are included in the scope of Section 21 *Provisions and Contingencies*.

### **Structure of this paper**

6. This paper is structured as follows:
  - (a) background (paragraphs 7–14);
  - (b) feedback on the Request for Information *Comprehensive Review of the IFRS for SMEs Standard* (Request for Information) (paragraphs 15–26);
  - (c) feedback on the proposals in the Exposure Draft (paragraphs 27–30);
  - (d) staff analysis (paragraphs 31–54);
  - (e) staff recommendation (paragraph 55);
  - (f) next steps (paragraph 56);
  - (g) Appendix A—extracts from the Basis for Conclusions on the Exposure Draft; and
  - (h) Appendix B—extracts from Section 21 and Section 33 *Related Party Transactions* of the Standard.

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## Background

### ***SMEIG Q&A on issued financial guarantee contracts***

7. In 2017, the SME Implementation Group (SMEIG) developed Q&A 2017/12.1 *Accounting for financial guarantee contracts in individual or separate financial statements of the issuer* because it was informed of two different views on how to apply the Standard to intragroup financial guarantee contracts issued by a parent company:
- (a) View 1—the parent entity should apply Section 21 *Provisions and Contingencies* to issued financial guarantee contracts. Those supporting this view applied the accounting policy hierarchy in paragraphs 10.4–10.6 of Section 10 *Accounting Policies, Estimates and Errors* because they question whether the Standard has specific requirements for accounting for financial guarantee contracts.
  - (b) View 2—the parent entity should apply Section 12 *Other Financial Instrument Issues* to issued financial guarantee contracts. Those supporting this view consider the issued financial guarantee contract to be a financial liability within the scope of Section 12.
8. Q&A 2017/12.1 clarifies that an issued financial guarantee contract is a financial liability of the entity, therefore the requirements in Section 12 apply (see paragraphs 11–12 of this paper) unless the entity chooses the option in Sections 11 and 12 to apply the recognition and measurement requirements of IAS 39 *Financial Instruments: Recognition and Measurement* (fallback to IAS 39).<sup>1</sup>
9. In the Basis for Conclusions accompanying Q&A 2017/12.1, the SMEIG recommended the IASB revisit the accounting treatment for issued financial guarantee contracts during the second comprehensive review of the Standard with a

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<sup>1</sup> The Exposure Draft proposed an amendment to the *IFRS for SMEs Accounting Standard* to remove an entity's option to apply the recognition and measurement requirements of IAS 39 *Financial Instruments: Recognition and Measurement*.

view to providing measurement relief. The SMEIG made this recommendation based on feedback that measuring issued financial guarantee contracts applying Section 12 is more complex than the accounting requirements in full IFRS Accounting Standards.

10. The initial question raised with the SMEIG was an example of a parent entity issuing a financial guarantee contract on behalf of its subsidiary. In discussing the issue, the SMEIG concluded that the accounting requirements in Section 12 of the Standard would apply whenever an SME issued a financial guarantee contract on behalf of another entity, with the parent-subsidiary case provided as an example.

### ***Accounting for issued financial guarantee contracts***

#### *Applying Section 12 of the Standard*

11. The *IFRS for SMEs* Accounting Standard does not have specific requirements for financial guarantee contracts. However, an issued financial guarantee contract meets the definition of a financial liability within the scope of Section 12.
12. Applying Section 12, an issued financial guarantee contract is initially and subsequently measured at fair value with changes in fair value recognised in profit or loss.

#### *Applying IFRS 9*

13. IFRS 9 *Financial Instruments* defines a financial guarantee contract as:

A contract that requires the issuer to make specified payments to reimburse the holder for a loss it incurs because a specified

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debtor fails to make payment when due in accordance with the original or modified terms of a debt instrument.

14. Applying IFRS 9, a financial guarantee contract issued by an entity is measured initially at fair value and measured subsequently at the higher of:<sup>2</sup>
- (a) the amount of the loss allowance (the allowance for expected credit losses); and
  - (b) the amount initially recognised less, when appropriate, the cumulative amount of income recognised applying the principles of IFRS 15 *Revenue from Contracts with Customers*.

## Feedback on the Request for Information

### ***Question in the Request for Information***

15. In view of the SMEIG recommendation that the IASB revisit the accounting treatment for issued financial guarantee contracts during this second comprehensive review (see paragraph 9), the IASB decided not to seek views on incorporating Q&A 2017/12.1 into the *IFRS for SMEs* Accounting Standard. Instead, the IASB sought views on aligning the accounting requirements for issued financial guarantee contracts with IFRS 9.
16. Question S3E of the Request for Information asked for views on the following proposed amendments to the requirements in the *IFRS for SMEs* Accounting Standard:
- (a) adding the definition of a financial guarantee contract from IFRS 9; and
  - (b) aligning the requirements for issued financial guarantee contracts with IFRS 9.

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<sup>2</sup> Ref to paragraph 4.2.1(c)(i) of IFRS 9.

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***Feedback on the 2020 Request for Information***

17. Feedback generally supported introducing the definition of a financial guarantee contract from IFRS 9 into the Standard. However, respondents expressed mixed views about aligning the requirements in the Standard for issued financial guarantee contracts with IFRS 9.
18. Some respondents supported aligning the requirements in the Standard for issued financial guarantee contracts with IFRS 9 because they believe the requirements in IFRS 9 are simpler than applying Section 12. A few respondents said the requirements should be aligned with IFRS 9, but with some simplifications (for example, to the requirement to determine the amount of any expected credit losses) or permitting the use of the undue cost or effort exemption.
19. In contrast, some respondents did not support aligning the requirements in the Standard for issued financial guarantee contracts with IFRS 9 because in their view these requirements are too complex for SMEs. Most of these respondents suggested that an entity should apply the requirements of Section 21 to its financial guarantee contracts, which they said are simpler than the requirements in IFRS 9 and sufficient for financial reporting by SMEs.
20. Some respondents noted that the type of financial guarantee contracts commonly issued by SMEs are intragroup contracts and measuring the fair value of the contracts for the purposes of the requirements in Section 12 or IFRS 9 would be difficult and would provide limited information benefits for users of the financial statements. Some respondents suggested further simplifications are considered for intragroup financial guarantee contracts, for example including them in Section 21.

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**SMEIG recommendation<sup>3</sup>**

21. In September 2018, before development of the Request for Information, the staff consulted the SMEIG on whether SMEs frequently issued financial guarantee contracts. The majority of SMEIG members said SMEs in their jurisdictions issue financial guarantee contracts, particularly intragroup financial guarantee contracts.
22. The SMEIG also met on 4–5 February 2021 to discuss the feedback from stakeholders on the Request for Information:
  - (a) most SMEIG members said the feedback provided evidence for the IASB to introduce the definition of a financial guarantee contract from IFRS 9 into the Standard;
  - (b) some SMEIG members said entities should apply Section 21 to issued financial guarantee contracts because the requirements in Section 21 are simpler for SMEs; and
  - (c) one SMEIG member suggested aligning the requirements in the Standard for issued financial guarantee contracts with IFRS 9.

**Feedback on the Exposure Draft*****Proposals in the Exposure Draft***

23. The IASB's alignment approach treats alignment with IFRS Accounting Standards as the starting point for developing the *IFRS for SMEs* Standard, and applies the principles of relevance to SMEs, simplicity and faithful representation, including the assessment of costs and benefits, in determining whether and how that alignment should take place. In developing the Exposure Draft, the IASB tentatively decided that the relevance principle is met and therefore proposed

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<sup>3</sup> The Report on the SMEIG meeting, held via remote participation, on 4–5 February 2021 can be accessed [here](#).

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requirements in the Exposure Draft for issued financial guarantee contracts to align with IFRS 9, with simplifications.

24. The Exposure Draft proposed to:
- (a) introduce the definition of a ‘financial guarantee contract’ from IFRS 9; and
  - (b) require the issuer of a financial guarantee contract to initially measure the contract at the premium received (plus the present value of any future premium payments receivable) and subsequently measure it at the higher of:
    - (i) the expected credit losses; and
    - (ii) the amount initially recognised, if any, amortised on a straight-line basis over the life of the guarantee.
25. The proposed requirements for issued financial guarantee contracts in the Exposure Draft were developed on the basis that all SMEs would apply an expected credit loss model to financial assets measured at amortised cost (other than trade receivables and contract assets).
26. Appendix A to this paper includes extracts from the Basis for Conclusions on the Exposure Draft that further explain the IASB’s considerations when developing the proposals for issued financial guarantee contracts.

### ***Feedback on the proposals in the Exposure Draft***

27. The Invitation to Comment in the Exposure Draft did not ask a specific question about the proposed amendments for issued financial guarantee contracts. However, Question 11 of the Invitation to Comment asked a general question whether respondents have any comments on other proposed amendments in the Exposure Draft.
28. Most respondents either did not comment on the proposed amendments for issued financial guarantee contracts or they welcomed inclusion of requirements for issued financial guarantee contracts.



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29. However, some respondents expressed concerns about the proposed requirements for issued financial guarantee contracts. Some respondents noted that it is common for SMEs to issue intragroup financial guarantee contracts at zero-premium. Applying the proposals there would be no entries on ‘day 1’, but on ‘day 2’ the SME would have an immediate remeasurement to recognise the amount of expected credit losses, which would be recognised in profit or loss (a ‘day 2 loss’).
30. Respondents had the following suggestions for how to amend the proposals for issued financial guarantee contracts:
- (a) intragroup financial guarantee contracts or all financial guarantee contracts should be in the scope of Section 21.
  - (b) the information needs of financial statement users could be achieved by disclosure only.
  - (c) financial guarantee contracts should only be initially measured at the transaction price if one is charged. If no transaction price is charged (zero-premium), the financial guarantee contracts should be initially measured at fair value.
  - (d) subsequent measurement could be based on the higher of:
    - (i) the amount to be paid under the financial guarantee, where payment is probable (as defined in Section 21 for provisions); and
    - (ii) the amortised value of the initial cost.

## Staff analysis

31. The staff analysis is set out as follows:
- (a) why are we proposing to change the requirements in the Standard for issued financial guarantee contracts? (paragraph 32);
  - (b) what alternatives could we consider for accounting for issued financial guarantee contracts? (paragraphs 33–45);

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- (c) which of these alternatives should we require for intragroup financial guarantee contracts? (paragraphs 46–51); and
  - (d) do we need additional disclosure requirements for intragroup financial guarantee contracts? (paragraphs 52–54).

***Why are we proposing to change the requirements in the Standard for issued financial guarantee contracts?***

32. Feedback from respondents to the Request for Information and SMEIG members (see paragraphs 17 to 22 of this paper) provides evidence that the main driver for proposing changes to the requirements in Section 12 of the Standard is to provide relief from fair value measurement for issued financial guarantee contracts, particularly intragroup contracts.

***What alternatives could we consider for accounting for issued financial guarantee contracts?***

33. The staff have identified the following alternatives that might be considered for accounting for issued financial guarantee contracts issued by SMEs:
- (a) Approach 1—retain the existing requirements in the Standard—issued financial guarantee contracts would continue to be measured at fair value with changes in fair value recognised in profit or loss. The staff have noted why we are proposing to change the requirements in the Standard in paragraph 32 of this paper.
  - (b) Approach 2—apply Section 21 *Provisions and Contingencies*—issued financial guarantee contracts would be in the scope of Section 21<sup>4</sup> (paragraphs 34–37).

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<sup>4</sup> Section 21 is based on IAS 37 *Provisions, Contingent Liabilities and Contingent Assets*.

- (c) Approach 3—IFRS 9 approach with simplifications—this is the approach proposed in the Exposure Draft (paragraphs 38–40).
- (d) Approach 4—IAS 39 approach with simplifications—consider the accounting requirements for issued financial guarantee contracts under full IFRS Accounting Standards prior to introduction of an expected credit loss (ECL) model, with appropriate simplifications<sup>5</sup> (paragraphs 41–45).

*Approach 2—apply Section 21 Provisions and Contingencies*

34. Some respondents to the Request for Information suggested that an entity should apply the requirements of Section 21 *Provisions and Contingencies* to issued financial guarantee contracts. These respondents noted that this suggestion would be simpler than the requirements for issued financial guarantee contracts in IFRS 9 and would be sufficient for financial reporting by SMEs. The staff have received feedback that SMEs in some jurisdictions apply Section 21 to issued financial guarantee contracts (see View 1 in paragraph 7(a) of this paper) because of the absence of specific requirements in the Standard.
35. In addition, the staff note that FRS 102 *The Financial Reporting Standard applicable in the UK and Republic of Ireland*, the UK Standard based on the *IFRS for SMEs Accounting Standard*, includes financial guarantee contracts within the scope of Section 21 *Provisions and Contingencies* of FRS 102<sup>6</sup>. The decision by the UK Financial Reporting Council to include financial guarantee contracts in Section 21 of FRS 102 was made to maintain consistency with the accounting requirements that existed under previous UK GAAP. The UK FRC is not aware of this treatment not working in practice.<sup>7</sup>

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<sup>5</sup> Under IAS 39 *Financial Instruments: Recognition and Measurement*, an issued financial guarantee contract was initially recognised at fair value and then subsequently measured at the higher of (a) the amount determined in accordance with IAS 37 *Provisions, Contingent Liabilities and Contingent Assets* and (b) the amount initially recognised less, when appropriate, cumulative amortisation recognised in accordance with IAS 18 *Revenue*.

<sup>6</sup> Financial guarantee contracts are within the scope of Section 21 of FRS 102 unless an entity has chosen to apply IAS 39 and/or IFRS 9, or has an existing accounting policy of insurance contract accounting for financial guarantee contracts and chooses to continue to apply that policy under FRS 103 *Insurance Contracts*.

<sup>7</sup> See the UK FRC comment letter ([CL11](#)) on the Request for Information.

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36. Applying Section 21, a provision is only recognised when an outflow of resources is probable and the amount can be reliably measured. Therefore, under Approach 2, an issued financial guarantee contract would not be recognised unless an outflow of resources is probable. However, disclosure could be required if the financial guarantee contract gives the SME a contingent liability.
37. However, a drawback of including issued financial guarantee contracts in the scope of Section 21 of the Standard is an issued financial guarantee contract meets the definition of a financial liability and there would be no conceptual reason for excluding it from Section 11 of the Standard.

*Approach 3—IFRS 9 approach with simplifications*

38. Applying IFRS 9, a financial guarantee contract issued by an entity is measured initially at fair value and subsequently measured at the higher of: <sup>8</sup>
- (a) the amount of the loss allowance (the allowance for expected credit losses); and
  - (b) the amount initially recognised less, when appropriate, the cumulative amount of income recognised applying the principles of IFRS 15 *Revenue from Contracts with Customers*.
39. Feedback from some respondents to the Request for Information was that the requirements for issued financial guarantee contracts in IFRS 9 are too complex for SMEs. Responding to this feedback, the IASB proposed the following simplifications for SMEs in the Exposure Draft (see Appendix A to this paper):
- (a) the contract would be initially measured at the premium received.<sup>9</sup> This simplification would respond to feedback that determining the fair value of an issued financial guarantee contract is difficult, particularly for intragroup contracts. The simplification is also consistent with the requirement in

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<sup>8</sup> Refer to paragraph 4.2.1(c) of IFRS 9.

<sup>9</sup> including the present value of any future premium payments receivable.

paragraph 11.13 of the Standard that a basic financial asset or liability is initially measured at the transaction price unless the arrangement constitutes a financing transaction.

- (b) the wording in paragraph 4.2.1(c)(i) of IFRS 9 (see paragraph 38(b) of this paper) would be simplified by referring to ‘the amount initially recognised, if any, amortised on a straight-line basis over the life of the guarantee’. The IASB observed the outcome of applying this wording would be similar to the outcome of applying paragraph 4.2.1(c)(i) of IFRS 9 for the types of financial guarantee contracts commonly issued by entities applying the Standard (although the amount initially recognised may not be fair value). Furthermore, this wording would be easy to apply and be understood by SMEs and users of their financial statements.

40. The proposed requirements in the Exposure Draft were developed on the basis that all SMEs would apply an ECL model to financial assets measured at amortised cost (other than trade receivables and contract assets). These proposed requirements would require the expected credit losses on the financial guarantee contract to be measured at each reporting date (see paragraph 24(b)). However, in January 2024, the IASB tentatively decided to require SMEs that do not provide financing to customers as one of their primary businesses to continue to use the incurred loss model to measure the impairment of their financial assets. Therefore, a drawback of Approach 3 is most SMEs will not be required to apply an ECL model to their financial assets. Feedback on the Exposure Draft indicated that the existence of two impairment models for financial instruments would lead to complexity and confusion for SMEs and users of their financial statements. Therefore Approach 3 may only be viable for those SMEs that use an ECL model.

#### *Approach 4—IAS 39 approach with simplifications*

41. For SMEs that will continue to apply an incurred loss model to their financial assets, the IASB could consider the requirements for issued financial guarantee contracts that previously existed applying IAS 39, which also used an incurred loss

model. In developing IFRS 9, the IASB retained the accounting treatment in IAS 39 for issued financial guarantee contracts, except to replace the amount determined under IAS 37 with the new impairment requirements.

42. Applying IAS 39, an issued financial guarantee contract was initially recognised at fair value and then subsequently measured at the higher of:
- (a) the amount determined in accordance with IAS 37 *Provisions, Contingent Liabilities and Contingent Assets*; and
  - (b) the amount initially recognised less, when appropriate, cumulative amortisation recognised in accordance with IAS 18 *Revenue*.
43. Applying the same simplifications described in paragraph 39 of this paper to the requirements in IAS 39 would result in the following simplified requirements for SMEs:
- An issuer of a financial guarantee contract would initially measure the contract at the premium received (plus the present value of any future premium payments receivable) and subsequently measure it at the higher of:
- (a) the amount determined in accordance with Section 21 *Provisions and Contingencies*; and
  - (b) the amount initially recognised, if any, amortised on a straight-line basis over the life of the guarantee.
44. Under Approach 4 if the premium received is zero (zero-transaction price) and an outflow of resources is never probable, then the issued financial guarantee contract would not be recognised (neither initially nor subsequently). Therefore, the accounting outcome would be similar to applying Section 21.
45. Approach 4 would be more complex to apply than Approach 2 (Section 21 *Provisions and Contingencies*). Therefore, we should consider whether the costs of applying Approach 4 would justify the benefits to users of the financial statements.

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***Which of these alternatives should we require for intragroup financial guarantee contracts?***

46. Feedback from some respondents indicates that obtaining fair value information about intragroup financial guarantee contracts for the purposes of applying the requirements in Section 12 or IFRS 9 (or IAS 39) would be difficult and would provide limited benefits for users of the financial statements.
47. Often intragroup financial guarantee contracts are issued at zero-premium. The staff note the following problems with requiring the contract to be initially measured at the premium received (under Approach 3 or 4) for financial guarantee contracts that are issued at a zero-premium:
- (a) some respondents raised concerns that a simplified IFRS 9 approach causes a ‘day 2 loss’ issue (see paragraph 29 of this paper); and
  - (b) applying a simplified IAS 39 approach would result in the same accounting outcome as application of Section 21/IAS 37 (see paragraph 44 of this paper).
48. Under an intragroup financial guarantee contract, a parent entity or fellow subsidiary might guarantee a third party loan of a subsidiary. In the consolidated financial statements of the parent the financial guarantee would not be recognised and the third party loan of the subsidiary would be recognised in full. Therefore, when accounting for intragroup issued financial guarantee contracts, we are considering the accounting treatment in the separate financial statements of the parent and the individual or separate financial statements of the subsidiary.
49. For the above reasons the staff think that the IASB should consider whether intragroup financial guarantee contracts issued at zero-premium should be included within the scope of Section 21, with additional disclosure if necessary. We do not think that accounting for these intragroup contracts applying Approaches 1, 3 or 4 would provide better information to users of SME financial statements than Approach 2, and therefore would introduce unnecessary complexity for SMEs.

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50. Intragroup financial guarantee contracts are often issued at a zero-premium. The staff think that if a premium is charged for an intragroup financial guarantee, there will often be a specific reason for doing so (for example, legal requirements). In this paper we are only considering intragroup financial guarantee contracts issued at a zero-premium. We will consider the requirements for other issued financial guarantee contracts at a future meeting.
51. The staff acknowledge applying Section 21 (Approach 2) to intragroup financial guarantee contracts, which meet the definition of a financial liability is not supported conceptually (as noted in paragraph 37 of this paper). However, we think including intragroup financial guarantees that are issued at a zero-premium in the scope of Section 21 (Approach 2) is best supported by our analysis. The IASB has, throughout this review, sought to simplify the current requirements (Approach 1). The proposals in the Exposure Draft need to be updated given the IASB's tentative decisions (Approach 3). Furthermore, Approach 4 would be more complex to apply than Approach 2, but the accounting outcome would be similar.

***Do we need additional disclosure requirements for issued financial guarantee contracts?***

52. If intragroup issued financial guarantee contracts issued at a zero-premium are included in the scope of Section 21, the disclosure requirements in paragraph 21.14 (outflow is probable) or paragraph 21.15 (outflow is not probable but is not remote) of the Standard would apply. The disclosure requirements in Section 33 would also apply to intragroup issued financial guarantee contracts, in particular paragraphs 33.9 and 33.10 of the Standard. These disclosure requirements are shown in Appendix B of this paper.
53. UK FRS 102 requires the following disclosures for issued financial guarantee contracts in the scope of Section 21:



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An entity shall disclose the nature and business purpose of the financial guarantee contracts it has issued. If applicable, an entity shall also provide the disclosures required by paragraphs 21.14 and 21.15.

54. The staff think the disclosure requirements in Section 21 and Section 33 are sufficient for intragroup financial guarantee contracts that are issued at a zero-premium. Paragraph 33.9(c) of the Standard requires details of any guarantees given or received for related party transactions. Therefore, we do not think we would need a similar disclosure requirement to UK FRS 102 for intragroup issued financial guarantee contracts.

***Staff recommendation and question for the IASB***

55. The staff recommend that intragroup financial guarantee contracts issued at a zero-premium are included in the scope of Section 21 (Approach 2 in this paper). We think the disclosure requirements in Section 21 and Section 33 are sufficient for such contracts and therefore we do not propose additional disclosure requirements.

Question for the IASB

Does the IASB agree with the staff recommendation in paragraph 55?

**Next steps**

56. The staff are currently researching possible implications of requiring SMEs that provide financing to customers as one of their primary businesses to use an ECL model for the impairment of their financial assets held at amortised cost. At a future meeting, the staff will ask the IASB to consider the research findings and also decide which of the four alternatives in this paper should apply to other financial guarantee contracts issued by SMEs.

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## Appendix A: Extracts from the Basis for Conclusions on the Exposure Draft

A1. The following extract summarises the considerations of the IASB when developing the proposals for issued financial guarantees.

BC100 To respond to feedback that the IFRS 9 requirements are too complex, the IASB is proposing these simplifications for SMEs:

- (a) the contract would be initially measured at the premium received (plus the present value of any future premium payments receivable). This simplification would respond to feedback that determining the fair value of an issued financial guarantee contract is difficult, particularly for related party contracts. The simplification is also consistent with the requirement in paragraph 11.13 of the Standard that a basic financial asset or liability is initially measured at the transaction price unless the arrangement constitutes a financing transaction.
- (b) the wording in paragraph BC99(b) would be simplified by referring to ‘the amount initially recognised, if any, amortised on a straight-line basis over the life of the guarantee’. The IASB observed that usually the outcome of applying this wording would be similar to the outcome of applying paragraph BC99(b) for the types of financial guarantee contracts commonly issued by entities applying the Standard (although the amount initially recognised may not be fair value). Furthermore, this wording would be easy to apply and be understood by entities applying the Standard and users of their financial statements.

BC101 Some IASB members expressed concern about recognising the financial guarantee contract at the premium receivable because users of financial statements might lose useful fair value information. These IASB members observed that the premium might be nil for related party financial guarantee contracts, such as intragroup financial guarantee contracts. Some IASB members were also concerned that if the financial guarantee is recorded on initial recognition at nil, this would lead to the recognition of expected credit losses in the period in which the guarantee was issued. Nevertheless, the IASB observed that under the proposed requirements the liability would, at a minimum, at each reporting date be subsequently measured at the amount of the allowance for expected credit losses, which would provide useful information in the statement of financial position about the entity’s exposure to credit risk.

BC102 Some IASB members expressed concerns about the cost of measuring expected credit losses for the financial guarantee contract at each reporting date. However, the IASB observed that this cost was a consequence of incorporating an expected credit loss model into the Standard. It also observed that there was no good reason to have a specific exception for financial guarantee contracts.

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## Appendix B: Extracts from Section 21 and Section 33 of the Exposure Draft

### Section 21 *Provisions and Contingencies*

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#### Disclosures about provisions

21.14 For each class of provision, an entity shall disclose all of the following:

- (a) a reconciliation showing:
  - (i) the carrying amount at the beginning and end of the period;
  - (ii) additions during the period, including adjustments that result from changes in measuring the discounted amount;
  - (iii) amounts charged against the provision during the period; and
  - (iv) unused amounts reversed during the period.
- (b) a brief description of the nature of the obligation and the expected amount and timing of any resulting payments;
- (c) an indication of the uncertainties about the amount or timing of those outflows; and
- (d) the amount of any expected reimbursement, stating the amount of any asset that has been recognised for that expected reimbursement.

Comparative information for prior periods is not required.

#### Disclosures about contingent liabilities

21.15 Unless the possibility of any outflow of resources in settlement is remote, an entity shall disclose, for each class of contingent liability at the reporting date, a brief description of the nature of the contingent liability and, when practicable:

- (a) an estimate of its financial effect, measured in accordance with paragraphs 21.7–21.11;
- (b) an indication of the uncertainties relating to the amount or timing of any outflow; and
- (c) the possibility of any reimbursement.

If it is **impracticable** to make one or more of these disclosures, that fact shall be stated.

### Section 33 *Related Party Disclosures*

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#### Disclosure of related party transactions

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33.9 If an entity has related party transactions, it shall disclose the nature of the related party relationship as well as information about the transactions, outstanding balances and commitments necessary for an understanding of the potential effect of the relationship on the financial statements. Those disclosure requirements are in addition to the requirements in paragraph 33.7 to disclose key management personnel compensation. At a minimum, disclosures shall include:

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- (a) the amount of the transactions;
  - (b) the amount of outstanding balances, including commitments and:
    - (i) their terms and conditions, including whether they are secured and the nature of the consideration to be provided in settlement; and
    - (ii) details of any guarantees given or received.
  - (c) provisions for uncollectable receivables related to the amount of outstanding balances; and
  - (d) the expense recognised during the period in respect of bad or doubtful debts due from related parties.

Such transactions could include purchases, sales or transfers of goods or services; **leases**; guarantees; and settlements by the entity on behalf of the related party or vice versa.

33.10 An entity shall make the disclosures required by paragraph 33.9 separately for each of the following categories:

- (a) entities with control, joint control or significant influence over the entity;
- (b) entities over which the entity has control, joint control or significant influence;
- (c) key management personnel of the entity or its parent (in the aggregate); and
- (d) other related parties.

...