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IFRS® Standards
Draft SMEIG Q&A

IFRS for SMEs® Standard

Accounting for financial guarantees in parent's separate financial statements (Section 12 *Other Financial Instrument Issues*, Issue 1)

About this Guidance

Draft questions and answers (Q&As) are developed by the SME Implementation Group (SMEIG), which assists the International Accounting Standards Board (Board) in supporting implementation of the *IFRS for SMEs* Standard. More information about the SMEIG can be found on our website: http://www.ifrs.org/groups/sme-implementation-group/.

The Q&As provide non-mandatory and timely guidance on specific accounting questions raised by entities implementing the *IFRS for SMEs* Standard, as well as other interested parties. The Board will consider all Q&As developed by the SMEIG at the next Board review of the *IFRS for SMEs* Standard. At that time, the Board will consider whether to incorporate any of the non-mandatory Q&A guidance in the *IFRS for SMEs* Standard.

Comments

The SMEIG invites comments on whether this draft Q&A provides useful and sufficient guidance on the issue covered.

Comment deadline: **1 September 2017**.

Comments must be submitted electronically via the IFRS Foundation's website: www.ifrs.org/projects/work-plan/smeig-qa-guidance/comment-letters-projects/draft-smeig-qa-june-2017/.

All comments will be posted on the IFRS Foundation's website unless the writer specifically requests confidentiality. In that case, the writer must support the request with a good reason, for example, maintaining commercial confidentiality.

Issue

A parent entity prepares separate financial statements applying the *IFRS for SMEs* Standard. The parent entity guarantees repayment of a loan from a bank to one of its subsidiaries. How does the parent entity account for the financial guarantee issued to the bank in its separate financial statements?

Response

The parent entity shall account for the financial guarantee by applying the requirements in Section 12 *Other Financial Instrument Issues*—unless the parent entity chooses to apply the recognition and measurement requirements of IAS 39 *Financial Instruments: Recognition and Measurement* (as permitted by paragraphs 11.2(b) and 12.2(b) of the *IFRS for SMEs* Standard).

Basis for Conclusions

BC1 The SMEIG considered the appropriate accounting treatment for financial guarantees issued by a parent entity that prepares separate financial statements applying the *IFRS for SMEs* Standard because it became aware of two different views on how to apply the *IFRS for SMEs* Standard to such transactions:

(a) View 1—the parent entity should account for the financial guarantee issued in accordance with Section 21. 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 *IFRS for SMEs* Standard has specific requirements for accounting for financial guarantees.

(b) View 2—the parent entity should account for the financial guarantee issued in accordance with Section 12. Those supporting this view treat the financial guarantee issued as a financial liability in the scope of Sections 11 and 12.

The SMEIG concluded that View 2 is the required accounting under the *IFRS for SMEs* Standard.

BC2 The *IFRS for SMEs* Standard defines a financial instrument as a contract that gives rise to a financial asset of one entity and a financial liability or equity instrument of another entity (paragraph 11.3). The financial guarantee issued by the parent entity is a contractual right of the bank to receive cash from the parent entity and a contractual obligation of the parent entity to pay cash to the bank if the subsidiary defaults. Consequently, the contract is a financial asset of the bank and a financial liability of the parent entity. The financial guarantee is therefore covered by the requirements for accounting for financial instruments in the *IFRS for SMEs* Standard.

BC3 Section 11 *Basic Financial Instruments* applies to basic financial instruments while Section 12 applies to other, more complex financial instruments and transactions. Because the financial guarantee is contingent on a future unknown event, the criterion that there are no conditional returns or repayment provisions in paragraph 11.9(d) is not satisfied. Therefore, the financial guarantee does not constitute a basic financial instrument as described in paragraph 11.8 because the parent's financial liability does not satisfy all the conditions in paragraph 11.9. The parent entity must account for the financial guarantee in accordance with Section 12.

BC4 Section 12 applies to all financial instruments except for exceptions listed in paragraph 12.3. One of these exceptions is rights under insurance contracts (paragraph 12.3(d)). A financial guarantee contract meets the definition of an insurance contract in the glossary of the *IFRS for SMEs* Standard. However, because the exemption in paragraph 12.3(d) applies only to rights under insurance contracts (financial assets) and not to obligations under insurance contracts (financial liabilities), the financial guarantee issued by the parent entity is in the scope of Section 12.

BC5 The appropriate accounting treatment for financial guarantees issued by an entity was raised with the SMEIG in the context of a parent entity issuing a financial guarantee on behalf of its subsidiary. However, the SMEIG observed that the same issue may arise in other circumstances, and that, in such cases, the same accounting treatment should be applied to accounting for the financial guarantee in the issuing entity's own financial statements. An example of where this might commonly arise is an entity issuing a financial guarantee on behalf of another entity where both entities are under common control.

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