

Guarantees Issued on Obligations of Other Entities

The Committee received a request about how an entity accounts for guarantees that it issues.

The request described three fact patterns in the context of an entity's separate financial statements. In the fact patterns, an entity issues several types of contractual guarantees on obligations of a joint venture. These fact patterns include situations in which the entity guarantees to make payments to a bank, a customer, or another third party in the event the joint venture fails to meet its contractual obligations under its service contracts or partnership agreements and fails to make payments when due.

The request asks whether the guarantees issued are financial guarantee contracts to be accounted for in accordance with IFRS 9 *Financial Instruments* and, if not, which other IFRS Accounting Standards apply to these guarantees.

Evidence gathered by the Committee indicated that, in practice, entities issue guarantees on obligations of their joint ventures and other entities (such as associates, subsidiaries or third parties), and those guarantees have a variety of terms and conditions. The Committee observed that questions relating to the accounting for issued guarantees arise both in the context of an entity's separate financial statements and consolidated financial statements.

Which IFRS Accounting Standards apply to issued guarantees?

Analysing the terms and conditions of a guarantee

Guarantees can arise or be issued in many ways and convey various rights and obligations to the affected parties. IFRS Accounting Standards do not define 'guarantees' and no single Accounting Standard applies to all guarantees.

An entity accounts for a guarantee that it issues based on the requirements, including the scoping requirements, in IFRS Accounting Standards and not based on the nature of the entity's business activities. An entity applies judgement in determining which IFRS Accounting Standard applies to a guarantee that it issues. In making that judgement, an entity is required to analyse all terms and conditions—whether explicit or implicit—of the guarantee unless those terms and conditions have no substance.

Is the guarantee a financial guarantee contract?

Based on the scoping requirements in IFRS 9, IFRS 17 *Insurance Contracts*, IFRS 15 *Revenue from Contracts with Customers* and IAS 37 *Provisions, Contingent Liabilities and Contingent Assets*, an entity first considers whether a guarantee it issues is a 'financial guarantee contract'. A 'financial guarantee contract' is defined in IFRS 9 as 'a contract that requires the issuer to make specified payments to reimburse the holder for a loss it incurs because a specified debtor fails to make payment when due in accordance with the original or modified terms of a debt instrument'. The term 'debt instrument' in the definition of a financial guarantee contract is not defined in IFRS Accounting Standards. The Committee was informed of diversity in practice in the interpretation of the meaning of the term 'debt instrument'.

Paragraph 2.1(e)(iii) of IFRS 9 and paragraph 7(e) of IFRS 17 state that financial guarantee contracts are within the scope of IFRS 9 (and IAS 32 *Financial Instruments: Presentation* and IFRS 7 *Financial Instruments: Disclosures*)—with one exception. If the issuer has previously asserted explicitly that it regards such financial guarantee contracts as insurance contracts and has used accounting that is applicable to insurance contracts, the issuer may elect to apply either IFRS 9 (and IAS 32 and IFRS 7) or IFRS 17. Paragraph 2.1(e)(iii) of IFRS 9 states that 'the issuer may make that election contract by contract, but the election for each contract is irrevocable'.

Is the guarantee an insurance contract?

If an entity concludes that the guarantee it issues is not a financial guarantee contract, the entity considers whether the guarantee is an 'insurance contract' as defined in IFRS 17. IFRS 17 applies to all insurance contracts, regardless of the type of entity issuing them.

IFRS 17 defines an ‘insurance contract’ as ‘a contract under which one party (the issuer) accepts significant insurance risk from another party (the policyholder) by agreeing to compensate the policyholder if a specified uncertain future event (the insured event) adversely affects the policyholder’. IFRS 17 defines ‘insurance risk’ as ‘risk, other than financial risk, transferred from the holder of a contract to the issuer’. Further application guidance on the definition of an ‘insurance contract’ and ‘significant insurance risk’ is provided in paragraphs B2–B30 of the Standard.

An entity also considers the scoping requirements in paragraphs 3–13 of IFRS 17, including:

- a. paragraph 7 of IFRS 17—which excludes from the scope of the Standard various items that might meet the definition of an insurance contract; and
- b. paragraphs 8–8A of IFRS 17—which permit an entity to choose to apply IFRS 17 to contracts that meet the definition of an insurance contract if the conditions set out in those paragraphs are met.

Other requirements in IFRS Accounting Standards that might apply

If an entity concludes that a guarantee it issues is neither a financial guarantee contract nor an insurance contract, the entity considers other requirements in IFRS Accounting Standards to determine how to account for the guarantee. These requirements include:

- a. IFRS 9—this Standard might be applicable if the guarantee is a loan commitment (see paragraph 2.3 of IFRS 9) or a derivative (as defined in Appendix A to IFRS 9), or otherwise meets the definition of a financial liability as defined in IAS 32.
- b. IFRS 15—this Standard might be applicable if the counterparty to the guarantee is a customer, and the guarantee is not within the scope of other IFRS Accounting Standards (see paragraphs 5–8 of IFRS 15).
- c. IAS 37—this Standard is applicable only if the guarantee gives rise to a provision, contingent liability or contingent asset that is not within the scope of other IFRS Accounting Standards (see paragraph 5 of IAS 37).

Conclusion

The Committee observed that an entity accounts for a guarantee it issues based on the requirements, including the scoping requirements, in IFRS Accounting Standards and not based on the nature of the entity’s business activities. An entity applies judgement in determining which IFRS Accounting Standard applies to a guarantee it issues and in considering the specific facts and circumstances and the terms and conditions of the guarantee contract.

The Committee noted that the IASB, at its April 2024 meeting, discussed diversity in practice in the interpretation of the term ‘debt instrument’ in the definition of a financial guarantee contract. The IASB decided to consider during its next agenda consultation the broader application questions related to financial guarantee contracts, including the meaning of the term ‘debt instrument’ in the definition of a financial guarantee contract. The Committee therefore concluded that an entity applies judgement in interpreting the meaning of the term ‘debt instrument’ when determining whether a guarantee is accounted for as a financial guarantee contract.

With regard to the scoping requirements in IFRS Accounting Standards, the Committee concluded that the principles and requirements in IFRS Accounting Standards provide an adequate basis for an entity to determine how to account for a guarantee that it issues.

Consequently, the Committee decided not to add a standard-setting project to the work plan.