



GRAP 104 on *Financial Instruments* (Revised)



Your guide to understanding and applying the revised Standard

This article is part of a series of articles that discuss the key amendments to GRAP 104 (revised). GRAP 104 is the authoritative source. Other supplementary resources are intended to be read alongside GRAP 104 and do not replace or override its guidance. The article has been prepared by the Secretariat of the ASB for information purposes only. It has not been reviewed, approved, or otherwise acted on by the Board.

GRAP 104 (revised) scopes in financial guarantee contracts

The revised GRAP 104 on *Financial Instruments* includes financial guarantee contracts issued by entities, which were previously outside the scope of this Standard.

What are financial guarantee contracts and how do they differ from other types of guarantees?

A financial guarantee contract obligates the issuer to make specified payments to reimburse the holder of the guarantee for losses incurred due to a debtor's failure to meet payment obligations under a debt instrument. This arrangement must be contractual and guarantee a specific debt arrangement between a lender and a borrower. It is important to distinguish these contracts from other arrangements, such as general performance guarantees or governmental obligations that do not guarantee a specific debt.

EXAMPLE

A typical example of a financial guarantee contract is where a controlling entity guarantees the specific debt of a controlled entity

Financial guarantee contracts issued by an entity are in the scope of GRAP 104. There are no accounting consequences for financial guarantees held by an entity, except as part of considering the cash flows that the entity expects to collect from the guarantee in the calculation of expected credit losses.

How should entities initially recognise and measure financial guarantee contracts issued?

Entities recognise financial guarantee contracts when they become parties to the contractual provisions, typically when the financial guarantee contract is issued. These contracts are initially measured at fair value, usually equal to the consideration received for issuing the guarantee.

In the public sector, guarantees are frequently issued in non-exchange transactions, i.e. at no or nominal consideration. In these cases, entities use market fees for directly equivalent financial guarantee contracts or estimate the fee using valuation techniques. If no reliable measure of fair value can be determined, an entity measures the financial guarantee contract issued initially at the loss allowance. The loss allowance represents the present value of the expected cash flows to reimburse the issuer of the guarantee for a credit loss that it incurs, less any amounts that the entity expects to receive from the holder, the debtor, or another party.

What are the measurement requirements after initial recognition?

After initial recognition, financial guarantee contracts are measured at the **higher** of:



In instances where the loss allowance is higher, an impairment loss is recognised.

When do entities derecognise financial guarantee contracts?

Derecognition occurs when contractual obligations are fulfilled, cancelled or expired. When the terms of a contract are revised, an entity considers whether the existing contract should be derecognised and a new financial liability recognised. This evaluation is based on whether the revised terms result in a change of more than 10% in the discounted present value of cash flows compared to the original financial liability. If so, the existing contract is derecognised, and a new financial liability is recognised.

What are the disclosure requirements for financial guarantee contracts?

Entities are required to disclose the measurement basis (or bases) used in preparing the financial statements and other relevant accounting policies that aid in understanding the financial statements. Entities should provide comprehensive disclosures, including:

- Nature and terms of issued financial guarantee contracts.
- Basis for measurement and impairment methodologies applied.
- Exposure to credit risks and strategies for risk management.
- Clear presentation in financial statements to aid understanding and decision-making.

Understanding financial guarantee contracts will assist entities in applying GRAP 104 on *Financial Instruments* (revised). Entities must begin collecting relevant information to support the presentation and disclosure of the nature, terms and risk exposure associated with financial guarantee contracts.

Resources

For further guidance related to financial guarantee contracts, refer to this [fact sheet](#).