ASB ACCOUNTING STANDARDS BOARD

FINANCIAL INSTRUMENTS FACT SHEET #7

FINANCIAL GUARANTEE CONTRACTS ISSUED		
Definition	A financial guarantee is 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 a payment in accordance with the terms of a debt instrument. The arrangement must (a) be contractual, and (b) guarantee a specific debt arrangement between a lender and a borrower. Government's obligations as a "lender of last resort", e.g. where government is obliged by legislation to guarantee the debts of entities or activities, are not financial guarantee contracts. This is because the arrangement is not contractual and there is no specific debt being guaranteed. Letters of support (often provided between group entities) need to be assessed against the definition of a financial guarantee contract to determine if they are financial guarantees. General guarantees for the payment of expenses, employees, shortfalls, deficits, etc. are not financial guarantees. Performance guarantees, e.g. where an entity agrees to make payments because an insufficient level of revenue is generated from an activity, are not the same as financial guarantees. Generally, performance and other guarantees are accounted for in terms of the GRAP 19 on *Provisions, Contingent Liabilities and Contingent Assets* (GRAP 19).	Paragraph 2.1, AG1.6 and BC19-BC28 Paragraph GRAP 19.05
Scope	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 when calculating expected credit losses).	Paragraph 1.3(d)
Recognition	Recognise financial guarantee contracts when an entity becomes party to the contractual provisions of the instrument, e.g. when the financial guarantee contract is issued.	Paragraph 3.1 and AG3.12-AG3.13
Classification	Fair value, with specific measurement after initial recognition.	Paragraph 4.7
Initial measurement	Fair value, which is usually equal to the consideration received for issuing the guarantee. Where no guarantee fee is charged, or the fee charged does not represent fair value (i.e. the guarantee is issued in a non-exchange transaction), an entity determines the fair value by reference to the price for a similar guarantee in an active market, or by using a valuation technique. Where no reliable measure of fair value can be determined, an entity measures the financial guarantee contract at the loss allowance.	Paragraph 5.1 and AG5.28-AG5.32, AG5.34-AG5.49
Subsequent measurement	Financial guarantee contracts are subsequently measured at the higher of fair value initially recognised less any amortisation of revenue (where applicable) and the loss allowance.	Paragraph 4.7 and 5.9
Impairment loss (recognised in statement of financial	The subsequent measurement of financial guarantees is the higher of the loss allowance and the initial fair value less accumulated amortisation. Where the loss allowance is higher, an impairment loss is recognised.	

This Fact Sheet explains the Secretariat's views on the possible accounting treatment of public sector transactions based on the principles in GRAP 104 on Financial Instruments (revised in 2019). This Fact Sheet accompanies, and is not a replacement for, the complete text of GRAP 104 Financial Instruments. The Fact Sheet outlines the most common features and accounting considerations related to a particular transaction. The accounting may differ depending on the facts and circumstances of individual arrangements. This Fact Sheet has not been reviewed, approved or otherwise acted on by the ASB.

performance)		
Loss allowance (statement of financial position)	The credit losses (loss allowance) represent the present value of the expected cash flows to reimburse the holder 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.	Paragraph 5.17-5.29, 5.32-5.35 and AG5.60-AG5.115
	Step 1: Use lifetime or 12-month expected credit losses Use of lifetime or 12-month credit losses depends on whether there has been a significant change in credit risk, i.e. change in risk of default occurring, since initial recognition (individual and collective assessment). An entity can assume there has been no significant change in credit risk if the instrument has low credit risk. Lifetime losses reflect the possible occurrence(s) of default over the lifetime of the instrument. 12-month losses reflect the occurrence(s) of default over the 12-month period from reporting date. 12-month losses are not the lifetime losses apportioned over the 12-month period, nor is it the cash losses that will occur in the next 12 months. Significant change in credit risk (including those that are credit impaired on origination) = use lifetime expected credit losses. No significant change in credit risk = use 12-month expected credit losses. Rebuttable presumptions (unless reasonable and supportable information to indicate otherwise): • Credit risk increased significantly when contractual payments more than 30 days past due. • Default does not occur later than when a financial asset is 90 days past due. Default can be determined for an earlier timeframe – an entity should develop a specific policy in this regard.	Paragraph 5.17-5.29, 5.32-5.35, and AG5.60-AG5.86
	Step 2: Measure expected credit losses The expected cash flows are based on the lifetime or 12 month expected credit losses. The contractual period is the maximum period allowed. Expected credit losses are measured so that the following is reflected: • An unbiased and probability-weighted amount of credit losses is determined by evaluating a range of possible outcomes with the risk of default occurring as the weight. An entity must consider the possibility that a credit loss occurs, as well as the possibility that no credit loss occurs. • Time value of money. This is the effective interest rate determined at initial recognition. Expected credit losses are determined based on reasonable and supportable information about past events, current conditions and forecasts of future economic conditions, that is available without undue cost or effort. Consider economic conditions of borrower as well as general economic conditions.	Paragraph 5.15-5.29, 5.32-5.35 and AG5.87 to AG5.115

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Derecognition	A financial guarantee contract is derecognised when the obligation is discharged, cancelled, expires or is waived. When the terms of the contract are revised, an entity considers whether the existing contract should be derecognised and a new financial liability recognised. When the terms are revised such that the discounted present value of the cash flows under the new terms are more than 10% different from the discounted present value of the remaining cash flows or the original financial liability, the existing contract is derecognised and a new financial liability recognised. An entity also considers qualitative factors that may affect the ongoing recognition of the instrument, e.g. a change in counterparty.	Paragraph 6.16-6.19 and AG6.15-AG6.21
Presentation and disclosure	An entity considers the presentation and disclosure requirements in GRAP 104 and applies materiality when preparing the financial statements. General disclosures – paragraphs 8.1 and 8.2 Accounting policies – paragraph 8.3 Classes of financial instruments and level of disclosure – paragraph 8.4 Significance of financial instruments to financial position and performance – paragraph 8.5 Statement of financial position – paragraphs 8.6, 8.23. Statement of financial performance – paragraphs 8.30. Nature and extent of risks arising from financial instruments – paragraphs 8.36 to 8.41, credit risk: 8.42-8.57, liquidity risk: paragraph 8.58, market risk (if significant exposure to market risk): paragraphs 8.59-8.60. More details for presentation and disclosure are discussed in Fact Sheets 12.	Presentation: paragraphs 7.1-7.17 and AG7.1-AG7.8

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