Comments on Tentative Agenda Decision:

Guarantee issued on obligations of Other Entities

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The committee has concluded that the principles and requirements of IFRS Accounting Standards provide an adequate basis for an entity to determine how to account for a guarantee it issues. In our view, this is not true.

To account for any transaction including issuance of a guarantee, both debit and credit sides must be clear. IFRS Accounting Standards provide an adequate basis for an entity to determine how to account for only the credit side of a guarantee it issues and that too only when the guarantee is issued in favour of a lender for a loan availed by the borrower. Without the clarification on 'debt instrument', IFRS accounting Standards could not be regarded as providing an adequate basis for an entity to determine the credit side of the guarantee liability. It is not clear whether counter guarantee issued for a guarantee is within the scope of IFRS 9 or IFRS 17 or IFRS 15 or IAS 37. Further, IFRS Accounting Standards do not provide an adequate basis for an entity to determine the debit side when an entity issues a guarantee for free.

Paragraph 60 of IFRS 13 states as follows:

If another IFRS requires or permits an entity to measure an asset or a liability initially at fair value and the transaction price differs from fair value, the entity shall recognise the resulting gain or loss in profit or loss unless that IFRS specifies otherwise.

In the case of guarantees issued for free, paragraph 60 of IFRS 13 would require the entity to account for the difference between the fair value and the transaction price of the guarantee in accordance with IFRS 9. Paragraph B5.1.1 and B5.1.2A of IFRS 9 provide guidance on accounting for the difference between the transaction price and initial fair value. Paragraph B5.1.1 of IFRS 9 states that the difference could be an income or expense or an asset. Paragraph B5.1.2A of IFRS 9 provides guidance on accounting for the difference when the difference is an income or expense based on level of fair value. What is not clear is can an issue of free guarantee be recognised as an asset. The broader problem is when does the difference between the initial fair value and transaction price qualify for recognition as an asset in separate financial statements of the issuer and / or in consolidated financial statements of the issuer group.

Parent companies recognise issue of guarantee for loans availed by subsidiary as investment in subsidiary, that is, as an asset, and measure the same at cost in accordance with paragraph 10 of IAS 27. It is not clear whether the issuance of free guarantee for loans availed by subsidiary from bank is within the scope of IFRS 9 and IAS 27 or only within the scope of IFRS 9. Paragraph B86(b) of IFRS 10 requires the carrying amount of the parent's investment in each subsidiary and the parent's portion of equity of each subsidiary to be eliminated. Thus, an interest in a subsidiary can be said to be an investment in subsidiary only when the same can be fully eliminated against the equity portion. The asset recognised for the issuance of guarantee does not, as such, have an equity in subsidiary though we have seen few companies creating an equity portion for the saving in interest cost. Thus, accounting for the guarantee asset as an investment in subsidiary may not be in accordance with IFRS 10. Accordingly, the asset recognised on issuance of the guarantee is not within the scope of IAS 27 and cannot be measured at cost. However, companies account for the guarantee asset as investment in subsidiary and measuring the same at cost as if it is within the scope of IAS 27 and also meets the conditions in paragraph B86(b) of IFRS 10.

Coming to guarantees issued for loans availed by associate or joint venture, companies recognise the debit side as investment in associate or joint venture at cost though the guarantee asset does not provide access to the returns associated with an ownership interest in an associate or joint venture. Therefore, the guarantee asset is not an investment in associate or joint venture that is accounted in accordance with IAS 28. Accordingly, the scope exemption in paragraph 2.1(a) of IFRS 9 do not apply to guarantee asset. Still the companies present guarantee as an investment in associate or joint venture at cost.

Companies disclose all guarantee whether performance or financial as contingent liability. One of the arguments is that under IFRS 9 the amount of the guarantee obligation is only the unamortised commission income. The nominal amount of the guarantee is much more than the commission income. There is also no specific disclosure requirement for financial guarantees in Ind AS 107. A guarantee issued by an entity. The agenda decision may clarify that guarantee can be disclosed as contingent liability only when the same are within the scope of IAS 37.