

Comments on IFRS IC Tentative Agenda Decision - "Guarantees Issued on Obligations of Other Entities"

To: The Accounting Standards Board (ASB) of ICAI

From: Bhopal Branch (CIRC) of ICAI

1. Consistency in Classification of Guarantees

Issue:

The agenda decision discusses the classification of guarantees as either **financial guarantee contracts under IFRS 9** or **insurance contracts under IFRS 17**. However, in certain business models, guarantees may have mixed features.

Suggestion:

We propose that the IFRS IC include **clear criteria** for distinguishing between **financial guarantees** and **insurance contracts** in situations where the features may overlap. For instance, in industries where entities issue guarantees covering both financial default (IFRS 9) and performance risk (IFRS 17), there should be guidance to help determine which standard applies. We recommend including **industry-specific examples** for sectors such as infrastructure, financial services, and manufacturing to provide clearer differentiation, ensuring that businesses can apply the correct standard consistently.

2. Risk Assessment and Materiality Considerations

Issue:

The agenda decision addresses recognition and measurement of guarantees based on credit risk, but there is limited guidance on **how materiality and risk assessments should be performed**, especially for guarantees issued for group entities.

Suggestion:

We recommend the agenda decision emphasize the need for a **structured approach to risk assessment** for guarantees, especially for group or related-party transactions. A detailed explanation of how to assess materiality based on factors such as **creditworthiness of the obligor**, **historical defaults**, and **probability of the guarantee being called upon** should be included. This will ensure that only **material guarantees** are recognized, preventing unnecessary overstatement of liabilities for guarantees with negligible risk. We also propose adding guidance on **risk sensitivity analysis**, to assist preparers in evaluating potential credit loss impacts.

3. Application in Emerging Economies (Context of India)

Issue:

In emerging markets like India, guarantees are often used by businesses, especially SMEs, to secure financing, and such guarantees can take forms that may not directly fit into the IFRS 9 or IFRS 17 frameworks.

Suggestion:

The agenda decision should explicitly recognize the **context of emerging economies**, where **personal guarantees** or guarantees issued by promoters are common. It should provide specific guidance on how these guarantees, which may not always involve immediate cash outflows or significant financial risk, should be measured and disclosed. We suggest including examples that consider **intra-group guarantees** or **promoter guarantees**, where the likelihood of enforcement is low but the guarantee adds value to securing financing. The measurement of such guarantees should reflect **realistic risk assessment** rather than strictly following fair value, as market data may not be readily available in such cases.

4. Recognition and Measurement of Financial Guarantees**Issue:**

The tentative decision briefly addresses the recognition of financial guarantees but does not go into enough detail on **how these should be measured**, particularly in the absence of active markets or pricing data.

Suggestion:

We propose that the agenda decision provide **detailed guidance** on the **measurement techniques** for financial guarantees when **observable market data is unavailable**. For example, guidance on using **expected credit loss models** for estimating provisions for such guarantees under IFRS 9 could be provided. Additionally, the decision should offer clarification on how to measure guarantees issued in markets where fair value information is limited or unavailable (a common issue in emerging economies), and propose the use of **simplified valuation techniques** or the **cost approach** in such cases. The agenda decision should also address **re-measurement and subsequent recognition** of guarantees as circumstances change.

5. Disclosure Requirements and Transparency**Issue:**

The decision refers to disclosure requirements but does not highlight **how detailed disclosures should be**, particularly when it comes to the nature, terms, and risks associated with guarantees.

Suggestion:

We suggest that the IFRS IC mandate **more detailed disclosures** regarding the **terms, nature, and risks** of guarantees issued on obligations of other entities, particularly focusing on **contingent liabilities**. This could include the requirement for entities to disclose **key assumptions** used in measuring guarantees, the **extent of financial exposure**, and any **mitigating factors** (such as collateral or counter-guarantees). These disclosures would provide users of financial statements with better insights into the potential impact of guarantees on financial position and performance, thereby enhancing transparency.

6. Distinguishing Between Financial and Operational Guarantees**Issue:**

The agenda decision does not provide guidance on how to handle **operational guarantees** issued in

the normal course of business, which do not neatly fall under financial guarantee contracts (IFRS 9) or insurance contracts (IFRS 17).

Suggestion:

We recommend that the agenda decision address **operational guarantees** issued as part of regular business operations (e.g., **performance guarantees, warranty guarantees**, etc.). These should be treated differently from financial guarantees, as their risk profiles and potential financial implications are different. The IFRS IC should consider issuing guidance on whether such guarantees should be recognized as **contingent liabilities under IAS 37** (Provisions, Contingent Liabilities, and Contingent Assets) or reported under another specific standard. This will help clarify treatment for industries that issue guarantees in the normal course of business, such as construction and infrastructure.

Conclusion:

We appreciate the opportunity to provide our **suggestions** on the IFRS IC's tentative agenda decision on "**Guarantees Issued on Obligations of Other Entities.**" Our suggestions aim to enhance clarity, improve consistency in application, and ensure the decision is relevant to both global standards and the Indian context.