Accounting for guarantees

There is no single accounting standard that deals with guarantees. How an entity accounts for a guarantee depends on the terms and conditions of the guarantee. The IFRIC recently explained the relevant standards and their interaction in an agenda decision.

The IFRIC recently published an agenda decision dealing with the accounting treatment of guarantees. The agenda decision stems from a request for clarity as to whether contractual guarantees issued by an entity in respect of obligations of a joint venture should be accounted for as financial guarantees under IFRS 9, or if not, guidance as to which standard to be applied then.

This article highlights key aspects of the decision that preparers issuing guarantees should consider.

Starting point

IFRS do not define the term guarantee, and there is no single standard that applies to all guarantees. The correct standard to apply depends on the implicit and explicit terms and conditions of the guarantee, rather than the reporting entity's business activities. Considering these terms and conditions, an entity must then apply the scoping and other requirements of various standards to determine how the guarantee should be accounted for.

Standard #1: IFRS 9

The IFRIC indicates that, based on the scoping requirements, the first standard to consider is IFRS 9 and whether the guarantee is a financial guarantee. That standard defines a financial guarantee 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'

Except when an entity has previously specifically asserted that it accounts for these guarantees as insurance contracts and accounted for them as such, IFRS 9 applies.

Standard #2: IFRS 17

If the guarantee is not a financial guarantee, it may be an insurance contract. An insurance contract is:

> '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'

Whether a contract meets this definition depends on whether the entity accepts significant insurance risk from another. Even if the contract satisfies this definition, the scope of IFRS 17 may exclude it, making it quite a complex standard to navigate in the context of guarantees.

Other standards

If the guarantee is not a financial guarantee or insurance contract, it may be:

- A loan commitment or derivative, accounted for in terms of IFRS 9.
- A contract with a customer accounted for under IFRS 15. This is if the counterparty and the guarantee does not fall under any other standard.
- A provision or contingent liability if no other standard applies.

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