

## accounting guideline AcG-14 disclosure of guarantees

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**PURPOSE AND SCOPE**

1 This Guideline presents the views of the Accounting Standards Board on the financial statement disclosures to be made by a guarantor about its obligations under guarantees. The purpose of this Guideline is to improve the transparency of a guarantor's disclosures about the obligations and risks arising from issuing guarantees.

2 The disclosure requirements in this Guideline supplement the disclosure requirements in CONTRACTUAL OBLIGATIONS, Section 3280, CONTINGENCIES, Section 3290, and FINANCIAL INSTRUMENTS, Section 3856, as they pertain to guarantees. This Guideline does not address the recognition or measurement of a guarantor's liability for obligations under a guarantee or the disclosure by a guaranteed party, which are subject to the requirements in Section 3290. This Guideline does not apply to obligations and contingencies other than guarantees.

3 This Guideline does not apply to the following guarantee contracts:

- (a) A guarantee or indemnification related to employee future benefits, as defined in EMPLOYEE FUTURE BENEFITS, Section 3462.
- (b) A lessee's guarantee of the residual value of leased property at the expiration of the lease term, when the lessee (guarantor) accounts for the lease as a capital lease under LEASES, Section 3065.
- (c) A contract providing for contingent rent that is accounted for under Section 3065.
- (d) A contract providing for payments that constitute a vendor rebate (by the guarantor) based on either the sales revenues of, or the number of units sold by, the guaranteed party.
- (e) A guarantee contract for which the underlying is related to the performance (regarding function, not price) of non-financial assets that are owned by the guaranteed party. Thus, this Guideline does not apply to product warranties issued by the guarantor, regardless of whether the guarantor is required to make payment in services or cash, including separately priced extended warranty or product maintenance contracts.
- (f) A guarantee or indemnification whose existence prevents the guarantor from being able to account for a transaction as the sale of an asset that is related to the guarantee's underlying, or to recognize in income the profit from that sale transaction.

**DEFINITIONS**

4 The following terms are used in this Guideline with the meanings specified:

- (a) A **guarantee** is:
  - (i) a contract that contingently requires the guarantor to make payments to the guaranteed party based on changes in an underlying that is related to an asset, a liability or an equity security of the guaranteed party;
  - (ii) a contract that contingently requires the guarantor to make payments to the guaranteed party based on another entity's failure to perform under an obligating agreement (a performance guarantee);
  - (iii) an indemnification agreement (contract) that contingently requires the indemnifying party (guarantor) to make payments to the indemnified party (guaranteed party) based on changes in an underlying that is related to an asset, a liability or an equity security of the indemnified party; or
  - (iv) an indirect guarantee of the indebtedness of another party, even though the payment to the guaranteed party may not be based on changes in an underlying that is related to an asset, a liability or an equity security of the guaranteed party.

Payments by the guarantor could involve a gross settlement, in which certain assets are concurrently transferred to the guarantor in exchange for the specified consideration (as in the settlement of an exercised put option or contingent forward contract), or a net settlement.

- (b) An **underlying** is a specified interest rate, security price, commodity price, foreign currency exchange rate, index of prices or rates, or other variable, including the occurrence or non-occurrence of a specified event (such as a scheduled payment under a contract).
- (c) An **indirect guarantee of the indebtedness of another party** is an agreement that obligates one entity to transfer funds to a second entity upon the occurrence of specified events under conditions whereby:
  - (i) the funds become legally available to creditors of the second entity; and
  - (ii) those creditors may enforce the second entity's claims against the first entity under the agreement.
- (d) A **payment** is the delivery of cash, financial instruments, other assets or the entity's own shares, or the provision of services.

5 Examples of items that fall within the definition of a guarantee include the following:

- (a) a financial standby letter of credit, which is an irrevocable undertaking (typically by a financial institution) to guarantee payment of a specified financial obligation;
- (b) a market value guarantee on either a financial asset (such as a security) or a non-financial asset owned by the guaranteed party;
- (c) a guarantee of the market price of the common shares of the guaranteed party;
- (d) a guarantee of the collection of the scheduled contractual cash flows from individual financial assets held by a special-purpose entity;
- (e) a performance standby letter of credit, which is an irrevocable undertaking by a guarantor to make payments in the event a specified third party fails to perform under a non-financial contractual obligation, and similar contracts such as bid bonds and performance bonds;
- (f) an agreement to advance funds if a second entity's net income, coverage of fixed charges, or working capital falls below a specified minimum; and
- (g) an agreement to indemnify another party in the event of an adverse judgment in a lawsuit or the imposition of additional taxes due to a change in the tax law or an adverse interpretation of the tax law.

6 Examples of items that do not fall within the definition of a guarantee include the following:

- (a) A commercial letter of credit, which is a document issued typically by a financial institution on behalf of a customer authorizing a third party (or, in special cases, the customer) to draw drafts on the financial institution up to a stipulated amount and with specified terms and conditions, or other loan commitment. Such commitments, which are commonly thought of as guarantees of funding, do not meet any of the four characteristics in the definition in paragraph 4(a). In particular, they do not guarantee payment of a money obligation and do not provide for payment in the event of default by the party drawing the draft.
- (b) An undertaking by an entity concerning its own future performance, for example:
  - (i) an undertaking by a lessee to indemnify the lessor if the lessee were to cause an adverse tax consequence for the lessor by any act, omission or misrepresentation with respect to the lease or the leased property;
  - (ii) an undertaking by a contractor to complete work under a contract by a specified deadline;
  - (iii) an undertaking by a purchaser to take the minimum amount under a take-or-pay contract; or
  - (iv) an undertaking not to take a certain future action.Such undertakings do not involve changes in an underlying of the guaranteed party or the failure of a third party to perform.
- (c) A non-contingent forward contract for which the net settlement can flow from either party to the other party. Guarantees are option-based contracts under which potential contingent cash flows can flow only from the guarantor to the guaranteed party. However, a contingent forward contract may meet one of the characteristics in paragraph 4(a) and be included in the scope of this Guideline.
- (d) An option-based contract such as a weather derivative in which the underlying is not an asset or liability of the guaranteed party.
- (e) A contract that provides for a vendor rebate based on the volume of purchases by the buyer. Such a rebate does not meet the definition in paragraph 4(a) because the underlying relates to an asset of the seller, not the buyer who receives the rebate.
- (f) A subordination arrangement under a securitization or other transaction by which the rights of some investors (or creditors) are subordinated to the rights of others, in which case, for example, the investors in one (subordinated) class or tranche of an entity's securities might not receive any cash flows until the investors in another (priority) class or tranche are fully paid. Such subordination arrangements are commonly thought of as guarantees issued by the subordinated investors because they provide credit protection, but they do not meet the definition in paragraph 4(a) because they do not provide for any payment by the subordinated investors.

**FINANCIAL INSTRUMENTS**, Section 3856, provides disclosure standards and valuation guidance with respect to retained interests from a securitization that are subordinated to more senior interests held by others.

- 7 To determine whether the characteristic in paragraph 4(a)(i) has been met for a put option written by a guarantor, the guarantor needs to know whether the guaranteed party has an asset or liability related to the underlying described in that paragraph. If, upon exercise, the put option requires gross settlement and the asset to be delivered under gross settlement is related to the underlying described in paragraph 4(a)(i), the characteristic in that paragraph are considered to be met. In contrast, if the put option permits or requires net settlement, the guarantor must consider its business relationship with the guaranteed party and the other circumstances involved in the issuance of the put option in deciding whether it is likely (as that term is used in **CONTINGENCIES**, Section 3290) that the guaranteed party has, on or about the date of the put option's issuance, an asset or liability related to the underlying described in paragraph 4(a)(i). If the guarantor has no basis for concluding that it is likely that the guaranteed party has that asset or liability, the characteristic in paragraph 4(a)(i) is not met for that written put option. For a put option that permits or requires net settlement and for which the characteristic in paragraph 4(a)(i) is considered to be met at inception, the guarantor continues complying with the disclosure requirements of this Guideline over the term of the put option without an ongoing assessment of whether the guaranteed party continues to have the related asset or liability over that period.
- 8 Guarantees issued between parents and their subsidiaries are intercompany transactions that, in effect, constitute put options given by one member of a consolidated group to another member of the same group and, accordingly, are eliminated on consolidation. Those guarantees are not subject to the requirements of this Guideline for purposes of consolidated financial reporting. A parent's guarantee of a subsidiary's debt to a third party does not involve an intercompany transaction. The subsidiary's debt to the third party is a liability of the consolidated entity. The parent's guarantee of that debt is simply a part of the consolidated entity's undertaking to make the scheduled payments on the debt. As indicated by paragraph 6(b), such an undertaking does not fall within the definition of a guarantee and is not subject to the requirements in this Guideline.

#### **DISCLOSURE**

- 9 A guarantor shall disclose the following information about each guarantee, or each group of similar guarantees, even when the likelihood of the guarantor having to make any payments under the guarantee is slight:
  - (a) The nature of the guarantee, including the approximate term of the guarantee, how the guarantee arose and the events or circumstances that require the guarantor to perform under the guarantee.
  - (b) The maximum potential amount of future payments (undiscounted) the guarantor could be required to make under the guarantee, before any amounts that may possibly be recovered under recourse or collateralization provisions in the guarantee (see (d) and (e) below). When the terms of the guarantee provide for no limitation to the maximum potential future payments under the guarantee, that fact shall be disclosed. When the guarantor is unable to develop an estimate of the maximum potential amount of future payments under its guarantee, the guarantor shall disclose the reasons why it cannot estimate the maximum potential amount.
  - (c) The current carrying amount of the liability, if any, for the guarantor's obligations under the guarantee (including the amount, if any, recognized under **CONTINGENCIES**, Section 3290), regardless of whether the guarantee is freestanding or embedded in another contract.
  - (d) The nature of any recourse provisions that enable the guarantor to recover from third parties any of the amounts paid under the guarantee.
  - (e) The nature of any assets held as collateral or by third parties that, upon the occurrence of any triggering event or condition under the guarantee, the guarantor can obtain and liquidate to recover all or a portion of the amounts paid under the guarantee.
- 10 Disclosure of accounting policies for the recognition and measurement of guarantee liabilities is provided in accordance with **DISCLOSURE OF ACCOUNTING POLICIES**, Section 1505.

- 11 Some guarantees are issued to benefit entities that meet the definition of a related party in **RELATED PARTY TRANSACTIONS**, Section 3840, such as joint arrangements and equity method investees. In those cases, the disclosures required by this Guideline may be in addition to the disclosures required by Section 3840.

#### **EFFECTIVE DATE AND TRANSITION**

- 12 Except as specified in paragraph 13, this Guideline applies to annual financial statements relating to fiscal years beginning on or after January 1, 2011. Earlier application is permitted.
- 13 Amendment to paragraph 11, issued in September 2014, applies to annual financial statements relating to fiscal years beginning on or after January 1, 2016. Earlier application is permitted.

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