Query No. 15

Subject: ***Accounting treatment in the Company's standalone financial statements for the Corporate Guarantee (Deed of Guarantee) issued by the Company being Parent Company to banks/suppliers/service providers on behalf of its Step-down subsidiary company.***[1]

A. Facts of the Case

1. A Company (hereinafter referred to as 'the Company') was incorporated on 16th August 1984 for procuring, transmission, processing and marketing of natural gas. The Company has an authorized share capital of Rs. 5,000 crore out of which Rs. 4,440.39 crore is paid-up share capital. The Government of India holds 51.45% equity of the Company at present. The Company is India's leading natural gas company with presence along the entire natural gas value chain comprising of exploration & production (E&P), LNG imports, gas transmission & marketing, gas processing, petrochemicals, LPG transmission, city gas distribution and power. The Company is having its global presence in various countries, such as, USA, Singapore, Myanmar, Egypt, China through subsidiaries/joint ventures (JVs)/associates etc. The securities of the Company are listed on the National Stock Exchange of India, the Bombay Stock Exchange and the London Stock Exchange (in the form of GDRs) with market capitalisation of over Rs. 61,000 crores (as of 31st March 2021). The Company's consolidated turnover for the year ended 31st March 2020 was approximately Rs. 72,400 crores with a profit after tax of Rs. 9,422 crores.

2. The Company has prepared its accounts as per Indian Accounting Standards (Ind ASs) w.e.f. 1st April 2016. In compliance to Companies (Indian Accounting Standards) Rules, 2015, the Company has prepared its financial statements for the financial year (F.Y.) 2016-17 with comparative figures for F.Y. 2015-16. The Company has adjusted the impact of transition from Indian Generally Acceptable Accounting Principles (I GAAP) to Ind AS in the opening reserve of 1st April 2015 and in the Statement of Profit and Loss for F.Y. 2015-16.

3. The Company has the following wholly owned subsidiary companies in USA:

   a) Subsidiary 1, which is a wholly owned subsidiary of the Company and is engaged in the E&P business.

   b) Step-down subsidiary, which is a wholly owned subsidiary of Subsidiary 1 and a Step-down subsidiary of the Company, and is engaged in LNG trading business.

At present, the Company has issued corporate guarantees on behalf of its US subsidiary, Subsidiary 1 and Step-down subsidiary to the tune of USD 1057.57 million (Rs. 7,810.15 crore). The Guarantee of USD 72.5 million (Rs. 535.41 crore) issued on behalf of Subsidiary 1 is towards meeting obligation of Subsidiary 1 and therefore, guarantee fee is being charged by the Company from Subsidiary 1 and as per the Company's assessment, presently there is no possibility of default by Subsidiary 1. Further, guarantees issued on behalf of Step-down subsidiary of USD 985.07 million (Rs. 7,274.73 crore), have been issued for furtherance of business of the company wherein ultimate beneficiary of these guarantees is the Company

[1] Opinion finalised by the Committee on 1.9.2021.

itself. As per the Company's assessment, there is no possibility of default by the Step-down subsidiary for meeting its obligation. Accordingly, the Company of the view that fair value of the guarantees is 'Nil' as the entire transaction is for the furtherance of business of the Company.

4. Facts of Step-down subsidiary and corporate guarantees provided on behalf of Step-down subsidiary are given hereunder:

Step-down subsidiary, a wholly owned subsidiary of Subsidiary 1, was established on March 28, 2013. On April 01, 2013, Step-down subsidiary executed a terminal service agreement (TSA) with M/s ABC, LP to book capacity rights of approximately 330,000 dekatherm per day (Dth/day) at the Dominion Cove Point LNG liquefaction terminal.

On December 12, 2014, Step-down subsidiary executed a pipeline service agreement (PSA) with M/s ABC, LP to secure pipeline transportation capacity rights of 430,000 Dth/day, in accordance with the broad terms and conditions of the pipeline precedent agreement (PPA) that Step-down subsidiary executed with M/s ABC, LP on April 1, 2013.

On November 30, 2014, Step-down subsidiary signed a gas sale and purchase agreement (GSPA) with M/s XYZ, Inc for sourcing of natural gas on a delivered basis at the inlet of the pipeline at the Dominion Cove Point LNG liquefaction terminal for a term of 20 years. The natural gas purchased from M/s XYZ Inc will be liquefied at the Dominion Cove Point LNG liquefaction Terminal.

During September 2017, the Company and Step-down subsidiary have entered into a LNG Sale & Purchase Agreement (SPA), wherein Step-down subsidiary is to sell the *entire quantity of LNG* to the Company *on back-to-back basis* on FOB US Coast basis *for the entire contract period of 20 years. The entire risks and obligations of* Step-down subsidiary *under the upstream contracts entered by* Step-down subsidiary *with its suppliers have been passed to the Company through the SPA*. The Company will take delivery of and pay for specified quantities of LNG procured by Step-down subsidiary, or compensate Step-down subsidiary for its costs incurred in the event that the Company fails to take delivery of the specified quantities (i.e., take or pay). Step-down subsidiary *bears limited risk and is acting as a low margin distributor and managing the operations of the contracts only*. Further, under Transfer Pricing Regulation, the Company has also filed Advance Pricing Agreement, and presently, Step-down subsidiary is charging 10% of value-added expenses as margin in overall value chain from the Company.

Under the LNG SPA, the Company is purchasing entire quantity of LNG from Step-down subsidiary and Step-down subsidiary is being reimbursed for (i) the cost of natural gas plus liquefaction expenses and other third-party costs; and (ii) all other expenses plus a mark-up.

(Emphasis supplied by the querist.)

5. In order to carry out the operations smoothly, as per contract terms, the Company has given the following corporate guarantees on behalf of Step-down subsidiary:

Date of Issue	Valid Up to	Company (To whom Guarantee Given)	Fund Based (FB) Amount In USD	Non-Fund based (NFB) Amount In USD	Fund Based (FB) Amount In Rs. - Crs.	Non-Fund based (NFB) Amount In Rs. - Crs.	Purpose of Guarantee
01.04.2013	31.12.2039	M/s ABC LP	0	$ 700 Mn	0	5169.50	Payment Security under TSA
01.04.2013	31.12.2039	M/s ABC LP	0	$ 90Mn	0	664.65	Payment Security under PPA
29.12.2014	28.12.2044	M/s XYZ Inc	0	$ 25Mn	0	184.63	Performance Guarantee for GSPA
24.04.2020	23.04.2021	State Bank of India, New York Branch	$70 Mn	0	516.95	0	*Working Capital Facility
28.09.2020	27.09.2021	Credit Agricole Corporate and Investment Bank	0	$100.06 Mn	0	739.01	*SBLC Facility

* *These Working Capital Facility and Stand-by Letter of Credit Facility (SBLC) are being renewed from same bank or another bank (based on the competitive rates) on yearly basis for next one year (12 months)*

The querist has stated that the performance of Step-down subsidiary under the contracts signed by it with its supplies are solely dependent upon the performance of the Company and the failure of payment to third parties (i.e. suppliers of Step-down subsidiary) is solely within the control of the Company. Therefore, the expected credit loss due to this guarantee is 'Nil'. Further due to the same reason, the Company is not charging any guarantee fee from the Step-down subsidiary for providing these guarantees. Charge for provision of guarantee would be appropriate where the issue of guarantee is considered to be a service performed by the issuer for the benefit of the entity availing the guarantee. However, in cases where the guarantee is for the benefit of the guarantor only, i.e., for promoting/ protecting its interest, no charge/ compensation for issue of guarantee is warranted.

Further, the Company is accounting for the amount payable for gas purchase from Step-down subsidiary in its books of account and if the Company provides loss allowance for guarantee given on behalf of Step-down subsidiary for the same transaction, it amounts to duplication and overstating the Company's liabilities.

It may also be noted that the parent companies of the counter parties of TSA & PPA *have also provided reciprocal Corporate Guarantee to Step-down subsidiary* for the performance of M/s ABC LP (Operator) and M/s XYZ Inc as follows:

Date of Issue	Valid Up to	Company (To whom Guarantee Given)	Guarantee Amount In USD	Non-Fund based (NFB) Amount In Rs. Crs.	Purpose of Guarantee
01.04.2013	31.12.2039	Step-down Subsidiary	$ 1750 Mn	12,923.75	Payment Security under TSA
01.04.2013	31.12.2039	Step-down Subsidiary	$ 150 Mn	1,107.75	Payment Security under PPA
29.12.2014	31.12.2039	Step-down Subsidiary	$ 25 Mn	184.63	Performance Guarantee for GSPA

It is quite clear that the parent company is required to provide corporate guarantee on behalf of its subsidiaries as newly formed subsidiaries do not have the requisite financial standing, credit worthiness and credit rating. However, these corporate guarantees could have been avoided, if the contracts would have been entered by the Parent Companies.

6. The querist has also stated that all the guarantees provided by the Company on behalf of Step-down subsidiary are in furtherance of the Company's business, wherein the Company is the ultimate beneficiary for these guarantees provided by the Company. Further, entire performance of Step-down subsidiary is also dependent upon the performance of the Company. *So, it can be construed that the Company has provided these guarantees for its own performance only.* (Emphasis supplied by the querist.)

Step-down subsidiary started its commercial operations in the year 2018. Since starting, Step-down subsidiary is having a back to back arrangement with the Company and the Company has lifted all its LNG cargos from the Step-down subsidiary on FOB US Coast basis. Some of these cargos are directly imported to India and some are sold in the international market by the Company. Further, if the Company charges guarantee fees to Step-down subsidiary, the same will be loaded in the gas cost along with the margin by Step-down subsidiary to the Company.

Till date, in this contract, there is no default on the part of Step-down subsidiary and the Company with respect to their contractual obligations, and hence, the corporate guarantees given by the company on behalf of Step-down subsidiary carry no risk. Further, in India, gas market is growing and the Government of India is also promoting use of LNG / R-LNG. The Company has laid additional pipeline network with approx. pipeline length of 2655 Km. Along the pipeline, approximately four fertilizer plants will get revived, and as a result, the LNG requirement in India will increase. Presently, natural gas share in the India energy basket is around 6% and the Government of India has set a target to increase the same to 15%. Therefore, it is expected that usage of natural gas in India will rise and due to limited domestic production of the gas, the same shall be met through imported LNG.

Currently, the Company is disclosing the above guarantees in Notes to Accounts under details of Loans, Investment, Guarantees and security given by the Company under the Companies

Act, 2013 and under Financial Risk Management (Liquidity Risk), as per the requirements of Ind AS 107, 'Financial Instruments: Disclosures'.

Documents separately provided by the querist for the perusal of the Committee:

1	Guarantee dated 01.04.2013 provided by the Company to M/s ABC LP for USD 700 million on behalf of the Step-down subsidiary for payment/ performance security under TSA
2	Guarantee dated 01.04.2013 provided by the Company to M/s ABC LP for USD 90 million on behalf of Step-down subsidiary for payment/ performance security under PPA
3	Guarantee Agreement dated 29.12.2014 provided by the Company to M/s XYZ Inc for USD 25 million on behalf of Step-down subsidiary for payment/performance security under GSPA
4	Letter of Guarantee dated 24.04.2020 provided by the Company to State Bank of India, New York Branch for USD 70 million on behalf of Step-down subsidiary for Working Capital Facility
5	Letter of Guarantee dated 19.08.2020 provided by the Company to Credit Agricole Corporate & Investment Bank Newyork for USD 100.06 million on behalf of Step-down subsidiary for SBLC Facility
6	Guarantee dated 01.04.2013 received from Parent of M/s ABC LP to Step-down subsidiary for USD 1750 million on behalf of M/s ABC LP for performance security under TSA
7	Guarantee dated 01.04.2013 received from Parent of M/s ABC LP to Step-down subsidiary for USD 150 million on behalf of M/s ABC LP for performance security under PPA
8	Guarantee dated 29.12.2014 received from Parent of M/s XYZ Inc to Step-down subsidiary for USD 25 million on behalf of M/s XYZ Inc for performance security under GSPA
9	LNG sale and Purchase Agreement between Step-down subsidiary and the Company

B. Query

7. In view of the above, the querist is hereby seeking opinion from the Expert Advisory Committee (EAC) of the Institute of Chartered Accountants of India on the following issues:

(i) As per Ind AS, whether any accounting treatment is required for the corporate guarantees provided on behalf of Step-down subsidiary for satisfaction of its obligations under the contract (i.e., TSA, PPA and GSPA), towards the suppliers (i.e., M/s ABC LP and M/s XYZ Inc) considering back to back contract with the Company for procuring 100% LNG from Step-down subsidiary and that there is no credit risk involved for Step-down subsidiary as 100% risk is transferred to the Company through SPA.

(ii) As per Ind ASs, whether any accounting treatment is required for the corporate guarantees provided on behalf of Step-down subsidiary, for obtaining working capital loan and SBLC facility from bankers, as the same have been availed by Step-down subsidiary to meet the temporary obligations to the suppliers, due to time lag between payment made by the Company to Step-down subsidiary and payment made by Step-down subsidiary to its suppliers.

(iii) Whether any expected credit loss is to be provided for any of the above guarantees as per Ind AS 109, 'Financial Instruments'.

(iv) Whether any other disclosure is required for any of the above guarantees in the Company's books of account, as presently, the Company is disclosing these guarantees under Notes to Accounts.

(v) Any other advice in the context, which EAC may deem fit.

C. Points considered by the Committee

8. The Committee notes that the basic issue raised by the querist relates to the accounting treatment of the bank guarantees provided by the Company on behalf of its Step-down subsidiary in the separate financial statements of the Company. The Committee has, therefore, considered only this issue and has not examined any other issue that may arise from the Facts of the Case, such as, accounting treatment of the purchase and sale agreement with the Step-down subsidiary, determining the fair valuation of the financial guarantee contracts, accounting in the financial statements of Subsidiary 1 and Step-down subsidiary company, accounting on transition to Ind ASs, accounting treatment of corporate guarantees on behalf of Subsidiary 1, accounting treatment in the consolidated financial statements of the Group, accounting treatment of performance guarantee received from suppliers, determination of fair value, etc. The Committee has only examined the issue from Ind AS perspective and has not examined the regulatory or legal classification and implications, including those arising under Income-tax Act and Foreign Exchange Management Act (FEMA). The Committee presumes that the Step-down subsidiary is not acting as an agent of the Company. The Committee also observes from the Company's financial statements that the Company has neither previously nor on transition to Ind ASs in the financial year 2016-17, asserted explicitly that it regards financial guarantee contracts as insurance contracts and uses accounting that it is applicable to insurance contracts. Consequently, the irrevocable option to treat the corporate guarantee as an insurance contract available under paragraph 2.1(e) of Ind AS 109 is not applicable. The Committee also wishes to point out that the accounting standards referred hereinafter are Indian Accounting Standards (Ind ASs), notified under the Indian (Accounting Standards) Rules, 2015.

9. The Committee notes that Appendix A to Ind AS 109 defines a financial guarantee contract as follows:

"**financial guarantee contract**	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."

Further, paragraphs B2.5 of Appendix B to Ind AS 109 and AG 8 of Appendix A to Ind AS 32, 'Financial Instruments: Presentation' provide as follows:

Ind AS 109

"B2.5 Financial guarantee contracts may have various legal forms, such as a guarantee, some types of letter of credit, a credit default contract or an insurance contract. Their accounting treatment does not depend on their legal form. The following are examples of the appropriate treatment (see paragraph 2.1(e)):

(a) Although a financial guarantee contract meets the definition of an insurance contract in Ind AS 104 if the risk transferred is significant, the issuer applies this Standard. Nevertheless, if the issuer has previously asserted explicitly that it regards such contracts as insurance contracts and has used accounting that is applicable to insurance contracts, the issuer may elect to apply either this Standard or Ind AS 104 to such financial guarantee contracts. If this Standard applies, paragraph 5.1.1 requires the issuer to recognise a financial guarantee contract initially at fair value. If the financial guarantee contract was issued to an unrelated party in a stand-alone arm's length transaction, its fair value at inception is likely to equal the premium received, unless there is evidence to the contrary. Subsequently, unless the financial guarantee contract was designated at inception as at fair value through profit or loss or unless paragraphs 3.2.15–3.2.23 and B3.2.12–B3.2.17 apply (when a transfer of a financial asset does not qualify for derecognition or the continuing involvement approach applies), the issuer measures it at the higher of:

(i) the amount determined in accordance with Section 5.5; and

(ii) the amount initially recognised less, when appropriate, the cumulative amount of income recognised in accordance with the principles of Ind AS 115 [see paragraph 4.2.1(c)].

(b) …"

Ind AS 32

"AG8 The ability to exercise a contractual right or the requirement to satisfy a contractual obligation may be absolute, or it may be contingent on the occurrence of a future event. For example, a financial guarantee is a contractual right of the lender to receive cash from the guarantor, and a corresponding contractual obligation of the guarantor to pay the lender, if the borrower defaults. The contractual right and obligation exist because of a past transaction or event (assumption of the guarantee), even though the lender's ability to exercise its right and the requirement for the guarantor to perform under its obligation are both contingent on a future act of default by the borrower. A contingent right and obligation meet the definition of a financial asset and a financial liability, even though such assets and liabilities are not

always recognised in the financial statements. Some of these contingent rights and obligations may be insurance contracts within the scope of Ind AS 104."

The Committee notes that a financial guarantee contract is defined under Ind AS 109 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*. For a financial guarantee under Ind AS 109 to exist, amongst others, there shall be a reimbursement for loss incurred by a specified debtor.

In the extant case, the Committee notes the following:

- In Documents 1 and 2 (as mentioned in the Table in paragraph 6 above) supplied alongwith the query, the Company has undertaken to irrevocably and unconditionally guarantee M/s ABC LP, prompt payment by the Step-down subsidiary of all the amounts that become due and payable by the Step-down subsidiary under the Terminal Service Agreement, up to amount stated in the respective agreements. In case of default in payment of guaranteed obligation by the Step-down subsidiary, the Company shall promptly pay M/s ABC LP.
- In Document 3 supplied alongwith the query, the Company has undertaken to irrevocably and unconditionally guarantee M/s XYZ Inc, prompt payment by the Step-down subsidiary of all the amounts that become due and payable by the Step-down subsidiary, up to $ 25 million. In case of default in payment of guaranteed obligation by the Step-down subsidiary, the Company shall promptly pay M/s XYZ Inc.
- In Document 4 supplied alongwith the query, the Company has undertaken to irrevocably and unconditionally guarantee State Bank of India, New York branch, due repayment of all amounts outstanding under credit facilities due and payable by the Step-down subsidiary to the extent of $ 70 million in the event of failure on the part of the Step-down subsidiary to repay the amount drawn under credit facilities.
- In Document 5 supplied alongwith the query, the Company has undertaken to irrevocably and unconditionally guarantee Credit Agricole, due repayment of all amounts outstanding under credit facilities due and payable by the Step-down subsidiary to the extent of $ 100 million in the event of failure on the part of the Step-down subsidiary to repay the amount drawn under credit facilities.

The Committee notes that the term 'debt instrument' is neither defined in Ind AS 109 nor in Ind AS 32. The Committee is of the view that the term implies a contractual right to receive cash arising on account of a debtor-creditor or lender-borrower relationship. The Committee is of the view that apparently there is debtor-creditor or lender-borrower relationship between the Step-down subsidiary and the holder/beneficiary of the guarantee contract (viz., M/s ABC LP, M/s XYZ Inc, SBI etc.) under the terms of TSA/PPA/GSPA/credit facilities etc. In case the Step-down subsidiary does not make payment to the holder/beneficiary of the guarantee (viz., M/s ABC LP, M/s XYZ Inc, SBI etc.) under TSA/PPA/GSPA or credit facilities, the holder has a right to recoup the loss suffered by it from the Company. The Committee is, therefore, of the view that the corporate guarantee issued by the Company to the various parties mentioned above meets the definition of financial guarantee contract given in Ind AS 109. The Committee is also of the view that there exists a contractual right of the holder of the guarantee contract, to receive cash from the guarantor (viz., the Company) and a

corresponding contractual obligation of the guarantor to pay the holder, if the Step-down subsidiary defaults. This is so even if the holder's ability to exercise its right and the requirement for the guarantor to perform under its obligation are both contingent on future act of default on future payments becoming due and payable by the Step-down subsidiary. Therefore, the contingent right and obligation meet the definition of financial guarantee contract, in accordance with the requirements of paragraph AG 8 of Ind AS 32.

The Committee further notes that the querist has argued that the performance of Step-down subsidiary under the contracts signed by it with its suppliers are solely dependent upon the performance of the Company and the failure of payment to third parties (i.e. suppliers of Step-down subsidiary) are solely within the control of the Company. Therefore, the expected credit loss due to this guarantee is 'Nil'. Further due to the same reason, the Company is not charging any guarantee fee from Step-down subsidiary for providing these guarantees. Charge for provision of guarantee would be appropriate where the issue of guarantee is considered to be a service performed by the issuer for the benefit of the entity availing the guarantee. However, in cases where the guarantee is for the benefit of the guarantor only, i.e., for promoting/protecting its interest, no charge/compensation for issue of guarantee is warranted.

The Committee also notes that the querist has also put forth an argument that the Company is accounting for amount payable for gas purchase from Step-down subsidiary in its books of account and if the Company provides loss allowance for guarantee given on behalf of Step-down subsidiary for the same transaction, it amounts to duplication and overstating the Company's liabilities.

The Committee notes that the trade payable for the gas purchased from the Step-down subsidiary and the financial guarantee issued by the Company to third party on behalf of the Step-down subsidiary are separate financial liabilities emanating from separate transactions. The Company has obligations towards different parties in the two transactions. Therefore, the Committee is of the view that recogising the two financial liabilities and providing for loss allowance on the financial guarantee contract shall not result in duplication or overstating of liabilities. Further, as also pointed out by the querist, since there could be time lag in the payment made by the Company to Step-down subsidiary and payment made by the Step-down subsidiary to its suppliers, it may result in expected credit losses at the reporting date for some time till the payment becomes due from the Parent company from the perspective of the Step-down subsidiary (refer paragraph B 5.5.28 of Ind AS 109).

10. The Committee further notes that another argument put forth by the querist is that these guarantees could have been avoided, if the contracts would have been entered by the Company itself. All the guarantees provided by the Company on behalf of Step-down subsidiary are in furtherance of the Company's business, wherein the Company is the ultimate beneficiary for these guarantees provided by the Company. Further, entire performance of Step-down subsidiary is also dependent upon the performance of the Company. So, it can be construed that the Company has provided these guarantees for its own performance only.

The Committee believes that the financial guarantee provided to an external party on behalf of a subsidiary is required to be accounted for in the separate financial statements of the parent company as per Ind AS 109. This is notwithstanding the fact that the Step-down subsidiary's financial performance and position may be dependent on the business that is generated with the Company and that the Company being the ultimate parent of the subsidiary, is ultimately

the beneficiary of the subsidiary's operation. From the perspective of the separate financial statements, the reporting entity is the parent company only and not the group, i.e., parent company together with the subsidiaries. Therefore, it does not matter if the financial performance of the Step-down subsidiary is dependent on its business operations with the Company.

Further, the querist has also argued that till date there is no default on the part of Step-down subsidiary and the Company w.r.t. their contractual obligations, hence the corporate guarantees carry no risk. The Committee is of the view that the extent of credit risk shall not affect the initial recognition of the financial guarantee liabilities. However, this may be one of the factors that the Company may consider for the purpose of fair valuation at the time of initial measurement and for measuring the expected credit loss at the time of subsequent measurement.

11. Further, with regard to accounting treatment of such financial guarantee, the Committee is of the view that the guarantee obligations, as mentioned above, should be recognised and measured as per the requirements of Ind AS 109 by the Company in its separate financial statements. In this regard, the Committee notes from paragraph B 2.5(a) of Ind AS 109 reproduced above and other requirements of Ind AS 109 (paragraphs 5.1.1, 5.1.1A and B5.1.1) that the issuer of a financial guarantee should recognise it initially at its fair value. The Committee is of the view that this requirement is also applicable in respect of a guarantee issued by a parent on behalf of its subsidiary and where no fee or commission is charged by the parent for issuance of such guarantee. Accordingly, in the extant case, the Company, in its separate financial statements, should initially recognise a liability (a deferred income such as 'unearned financial guarantee commission') at fair value which will be equivalent to an amount that the Step-down subsidiary would have paid to obtain a similar guarantee in a standalone arm's length transaction.

The Committee further notes that in the extant case, the guarantee obligation has been undertaken by the Company in its capacity as the ultimate parent of the Step-down subsidiary company. The Company has a right to future economic benefits arising from its overall investments in the Step-down subsidiary through its control over Subsidiary 1. In case the Company is not charging any guarantee commission or other consideration to the Step-down subsidiary company, upon initial recognition of the financial guarantee liability, the Company should recognise deemed investment in the Subsidiary 1 and the same should be accounted for as per the requirements of Ind AS 27.

12. The Committee also notes the requirements of Ind AS 109 in respect of subsequent measurement of financial guarantee as follows:

> **"4.2.1 An entity shall classify all financial liabilities as subsequently measured at amortised cost, except for:**
>
> **(a)** ***financial liabilities at fair value through profit or loss*****. Such liabilities, including** ***derivatives*** **that are liabilities, shall be subsequently measured at fair value.**
>
> **(b) financial liabilities that arise when a transfer of a financial asset does not qualify for derecognition or when the continuing involvement**

approach applies. Paragraphs 3.2.15 and 3.2.17 apply to the measurement of such financial liabilities.

(c) *financial guarantee contracts*. After initial recognition, an issuer of such a contract shall (unless paragraph 4.2.1(a) or (b) applies) subsequently measure it at the higher of:

(i) the amount of the *loss allowance* determined in accordance with Section 5.5 and

(ii) the amount initially recognised (see paragraph 5.1.1) less, when appropriate, the cumulative amount of income recognised in accordance with the principles of Ind AS 115.

…"

"5.5.1 An entity shall recognise a loss allowance for *expected credit losses* on a financial asset that is measured in accordance with paragraphs 4.1.2 or 4.1.2A, a lease receivable, a *contract asset* or a loan commitment and a financial guarantee contract to which the impairment requirements apply in accordance with paragraphs 2.1(g), 4.2.1(c) or 4.2.1(d)."

"B5.5.32 For a financial guarantee contract, the entity is required to make payments only in the event of a default by the debtor in accordance with the terms of the instrument that is guaranteed. Accordingly, cash shortfalls are the expected payments to reimburse the holder for a credit loss that it incurs less any amounts that the entity expects to receive from the holder, the debtor or any other party. If the asset is fully guaranteed, the estimation of cash shortfalls for a financial guarantee contract would be consistent with the estimations of cash shortfalls for the asset subject to the guarantee."

"5.7.9 Despite the requirements in paragraphs 5.7.7 and 5.7.8, an entity shall present in profit or loss all gains and losses on loan commitments and financial guarantee contracts that are designated as at fair value through profit or loss."

From the above, the Committee notes that as per the requirements of Ind AS 109, expected credit loss should be considered on financial guarantee contracts at the time of subsequent measurement.

13. The Committee notes that Ind AS 37, 'Provisions, Contingent Liabilities and Contingent Assets' states as follows:

"2 This Standard does not apply to financial instruments (including guarantees) that are within the scope of Ind AS 109, *Financial Instruments*."

Therefore, financial guarantees, in the extant case, being governed by Ind AS 109, are not within the scope of Ind AS 37 and therefore, can not be classified as contingent liabilities. Instead, the Company should comply with the relevant presentation and disclosure

requirements of Ind AS 107 and related disclosures of Division II of Schedule III to the Companies Act, 2013 for financial liability.

D. Opinion

14. On the basis of the above, the Committee is of the following opinion on the issues raised in paragraph 7 above:

(i) and (ii) The Company should account for the financial guarantee contracts as per the requirements of Ind AS 109, as discussed in paragraphs 9-12 above.

(iii) The Company should account for expected credit loss provision, if any, as per the requirements of Ind AS 109, as discussed in paragraph 12 above.

(iv) The disclosures in the Company's financial statements should be provided based on the classification as financial liabilities, as discussed in paragraph 13 above. The Company should comply with the relevant presentation and disclosure requirements of Ind AS 107 and Division II of Schedule III to the Companies Act, 2013.

(v) Refer above.

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