



CROWN FINANCIAL GUARANTEES

There are new requirements for reporting of Crown financial guarantees in general purpose financial reports. The previous NSWTC 06/15 *Crown Contingent Liabilities and Guarantees* is withdrawn.

Summary:

Changes to Accounting Standard AASB 139 'Financial Instruments: Recognition and Measurement' requires reporting entities to recognise the value of Financial Guarantees on their balance sheets beginning in 2006-07. This has necessitated an additional return to capture details of any Crown Financial Guarantees until a permanent process can be put in place. In addition, advice received recently on which agencies form part of the "Crown" has resulted in the withdrawal of NSWTC 06/15 'Crown Contingent Liabilities and Guarantees'.

INTRODUCTION

From 2006-07, Accounting Standard AASB 139 *Financial Instruments: Recognition and Measurement* requires reporting entities to recognise a financial guarantee liability on their balance sheet (if material), where they meet the definition of a 'financial guarantee contract'. Treasury will be updating TPP 06-04 *Accounting for Financial Instruments* for these changes.

As a result of this change, the Crown Entity (Crown) has introduced a new return to collect data on financial guarantees. In the past, financial guarantees would have been disclosed in the notes to the financial statements, as contingent liabilities (i.e. not recognised on the balance sheet). Under AASB 139 financial guarantees are now recognised on the balance sheet and not as contingent liabilities. Thus there is no need for any change to the instructions in NSWTC 07/05 *Financial Accounting Arrangements for the Crown Entity* for the collection of data for Contingent Liabilities.

A recent Crown Solicitor's advice indicating that only Government departments form part of the "Crown" contradicts statements in NSWTC 06/15 which form the basis of a significant part of the circular. Thus NSWTC 06/15 *Crown Contingent Liabilities and Guarantees* is withdrawn and replaced by this circular.

A new return is required to collect data on Crown Financial Guarantees for 2006-07. It is planned that a more permanent process will be introduced for 2007-08.

This Treasury Circular is a direction issued under section 9 of the *Public Finance and Audit Act 1983*.

Mark Ronsisvalle
for Secretary

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1. DEFINITION

Under AASB 139, a ‘financial guarantee’ contract is defined 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”. (AASB 139, para 9) (italics added)

Financial guarantee contracts may take various legal forms, such as a guarantee, some types of letters of credit, a credit default contract or an insurance contract. Their accounting treatment does not depend on their legal form (AASB 139, para AG4A).

2. EXCLUSIONS

Financial guarantee contracts exclude:

- Performance guarantees, (where the guarantor is not guaranteeing the payment of a debt);
- Letters of support between entities under common control, as the parent is usually not required to compensate any third party when the controlled entity defaults; and
- Statutory guarantees, as they are granted under statute rather than contract (AASB 132, para AG12). But, where a statute only provides the *power* to grant a guarantee (rather than granting the guarantee itself), any guarantee that is granted is regarded by NSW Treasury as a discretionary guarantee (rather than a statutory guarantee) that is potentially subject to AASB 139.

3. FINANCIAL GUARANTEES GIVEN UNDER THE PUBLIC AUTHORITIES (FINANCIAL ARRANGEMENTS) ACT 1987

Guarantees given under the *Public Authorities (Financial Arrangements) Act 1987* (PAFA) fall into two categories depending under which section of the Act they are given. Most of these guarantees are statutory guarantees under s 22A of the Act (whereby the Act *grants* the guarantee), which are excluded from the scope of AASB 139 (AASB 132, para AG 12). The most common example of the s22A statutory guarantee is agency borrowings from NSW Treasury Corporation (TCorp).

However, guarantees given under s 22B and s 22AA, where they satisfy the definition of a ‘financial guarantee contract’, are regarded by NSW Treasury as discretionary guarantees (rather than statutory guarantees) and subject to AASB 139. As discussed above, however, performance guarantees granted under these sections do not satisfy the definition of a ‘financial guarantee contract’ and are therefore excluded from the scope of AASB 139.

4. OTHER CROWN FINANCIAL GUARANTEES

The definition of a financial guarantee contract within AASB 139 seeks to capture all contracts “*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.*”

Although the term ‘debt instrument’ is used extensively, it is not defined. The term will typically be considered to include trade debts, overdrafts and other borrowings like loans and certain debt securities. Therefore this definition encompasses contracts other than just loan or credit facilities that generally require approval under the PAFA Act.

These could include (for example) purchase contracts for which a guarantee has been given on payments due under those purchase contracts. Hence, agencies should perform a review of their contractual arrangements and ensure that all Crown financial guarantee contracts are reported.

Crown financial guarantees may either relate to guarantees of the debts of NSW public sector agencies or of debts of parties outside of the NSW public sector.

5. RECOGNITION & MEASUREMENT

The recognition and measurement of financial guarantee contracts will be discussed in the revised TPP 06-4 *Accounting for Financial Instruments*. In general terms, financial guarantees under AASB 139 must initially be recognised by the issuer at 'fair value'. To determine fair value of Crown financial guarantees, a number of different matters will need to be considered, including the probability of default. Therefore, one of the objectives of the Crown Financial Guarantee Return (see below), is to collect information to assist in valuation of these guarantees.

6. THE CROWN FINANCIAL GUARANTEE RETURN

NOTE 1: This return is to be completed by all public sector agencies including;

- **General Government – Budget Dependent Agencies**
- **General Government – Non Budget Dependent Agencies**
- **Public Trading Enterprises (PTE)**
- **Public Financial Enterprises (PFE)**

NOTE 2: Where appropriate, a 'nil' return is to be submitted.

NOTE 3: If any detail shown changes subsequent to the provision of this return, the relevant page should be resent to the Crown Entity with the amended detail(s) highlighted.

NOTE 4: BEFORE completing the return, CHECK whether the guarantees to be reported

- 1) **have in fact been given by the Crown;**
- 2) **do meet the definition of a 'financial guarantee contract'; and**
- 3) **are not excluded from AASB 139 (e.g. performance guarantees).**

NOTE 5: There should be a separate sheet for each Crown Financial Guarantee with each sheet numbered in the space provided to identify the total number of sheets. For example 1 of 3, 2 of 3 and 3 of 3 if there are 3 sheets. Please make an attempt to complete all sections, more information is better, especially any data on which you based your responses. The Standard does not provide specific methodologies.

Each sheet must have a contact person who can answer questions on the guarantee. The last sheet should be signed off and dated by the Chief Financial Officer of the Agency.

The Crown Financial Guarantee Return is to be returned to the Crown Entity on or before 1 August 2007. The return can be mailed, faxed or emailed.

Postal Address: Finance Manager, Crown Entity
Crown Asset and Liability Management Branch
NSW Treasury
Level 24, Governor Macquarie Tower
1 Farrer Place, SYDNEY NSW 2000

Fax Number: (02) 9228 3210

Email Address: Crown_Entity@mail.treasury.nsw.gov.au

ATTACHMENT A:

Crown Financial Guarantees Return
Year Ending 30 June 2007

Agency Name: _____

FIS No: _____

Page: ____ of ____

1. Amount of Crown Guarantee	\$
2. Date of Crown Guarantee	
3. Description of guarantee (including the form of the guarantee (e.g. s22B), who and what is being guaranteed)	
4. Is the debt that is being guaranteed, recognised in the agency's own financial statements?	Yes / No
5. Likely loss arising from default-estimate at date of guarantee	\$
6. Probability of default-estimate at date of guarantee (consider factors such as the level of gearing / solvency and liquidity)	%
7. Is this guarantee disclosed or recognised in the agency's own financial statements	Yes / No
8. Would the agency need supplementation from the Consolidated Fund in case of a default? (Or reduce dividends, or require a grant?)	
9. How stable is the industry/ sector the guaranteed party operates in?	
10. What is the overall capital management framework that the guaranteed party operates in? (e.g. if the guaranteed party is a NSW public sector agency, is the agency subject to the Commercial Policy framework?)	
11. Probability of default – current estimate (If in default-100%)	%

12. If the guarantee relates to debt of parties outside of the NSW public sector, what was the interest differential at inception? (i.e. the difference between the interest rate at which the debt was provided, compared to the interest rate that would have applied had there been no financial guarantee)

Please provide details of a contact should there be any enquires:

Name: _____ Telephone: _____

I verify that all Financial Guarantees of the Crown known to this agency but not disclosed or recognised in the Financial Statements of this agency are listed above

Signed: _____ Dated: _____

Chief Finance Officer

Name: _____ * The certifying officer **must** be the Chief Finance Officer of the agency