

IFRS in Focus

IASB clarifies requirements for offsetting financial assets and financial liabilities and amends disclosures

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The Bottom Line

- The amendments to IAS 32 are intended to clarify existing application issues relating to the offsetting rules and reduce the level of diversity in current practice.
- The IASB and FASB published converged disclosure requirements which are intended to overcome the differences in their respective offsetting requirements.
- The new disclosures are required for annual or interim periods beginning on or after 1 January 2013 and the clarifying amendments to IAS 32 are effective for annual periods beginning on or after 1 January 2014. Both require retrospective application for comparative periods.

The amendments

In December 2011, the International Accounting Standards Board ('IASB' or 'the Board') amended the accounting requirements and disclosures related to offsetting of financial assets and financial liabilities by issuing amendments to IAS 32 *Financial Instruments: Presentation* and IFRS 7 *Financial Instruments: Disclosures*. These amendments are the result of the IASB and US Financial Accounting Standards Board ('FASB') (collectively 'the Boards') undertaking a joint project to address the differences in their respective accounting standards regarding offsetting of financial instruments.

In January 2011, the Boards published their proposals with the IASB issuing ED 2011/1 *Offsetting Financial Assets and Financial Liabilities*. The proposals would have retained the current model under IAS 32 but would have eliminated the exceptions in US GAAP for conditional rights of offset (e.g. under an ISDA master netting agreement in the event of default or bankruptcy). The FASB subsequently decided to retain those exceptions rather than to proceed with the proposals. As the Boards could not agree on the criteria for offset in the statement of financial position the Boards decided to develop converged disclosure requirements to allow comparison between financial statements prepared under IFRS and US GAAP.

For more information please see the following websites:

www.iasplus.com

www.deloitte.com

Amended disclosures

The amendments to IFRS 7 require an entity to disclose information about rights of offset and related arrangements (such as collateral posting requirements) for financial instruments under an enforceable master netting agreement or similar arrangement. At a minimum, entities should disclose (in a tabular format, separating financial assets and financial liabilities unless another format is more appropriate) the following information:

- a) the gross amounts of those recognised financial assets and recognised financial liabilities under an enforceable master netting agreement, or similar arrangement;
- b) the amounts offset in accordance with the criteria in IAS 32;
- c) the net amounts presented in the statement of financial position ((a) less (b));
- d) the amounts subject to an enforceable master netting arrangement or similar arrangement that are not included in (b); and
- e) the net amount after deducting the amounts in (d) from the amounts in (c) above.

The amounts disclosed in item (d) would include those rights to set-off amounts that are only enforceable and exercisable in the event of default, insolvency or bankruptcy. This would include amounts related to financial collateral both received and pledged, whether as cash or as non-cash collateral, excluding the extent of over-collateralisation.

These disclosures may be grouped entirely by type of financial instrument or transaction (e.g., derivatives, repurchase and reverse repurchase agreements or securities borrowing and lending arrangements) or by type of financial instrument for items (a) – (c) and then by counterparty for items (c) – (e). If the disclosures are provided by counterparty, the counterparty is not required to be identified by name but should be separated in to individually significant counterparties with immaterial counterparty exposures aggregated together (e.g. Counterparty A, Counterparty B, Other Counterparties).

Clarification of IAS 32

The proposals in the ED were largely similar to the existing requirements of IAS 32; however there were subtle differences that could have affected the application of the offsetting requirements under IFRS. Additionally, while conducting constituent outreach, the IASB staff observed differing interpretations and application of the offsetting requirements currently in IAS 32. Following consideration of these issues, the Board has amended IAS 32 to clarify the meaning of 'currently has a legally enforceable right of set-off' and 'simultaneous realisation and settlement'.

Meaning of 'currently has a legally enforceable right of set-off'

The amendments clarify that to result in offset of a financial asset and a financial liability, a right to set-off must be available today rather than being contingent on a future event and must be exercisable by any of the counterparties, both in the normal course of business and in the event of default, insolvency or bankruptcy. Also, the amendments clarify that the determination of whether the right meets the legally enforceable criterion will depend on both the contractual terms entered into between the counterparties as well as the law governing the contract and the bankruptcy process in the event of bankruptcy or insolvency.

Observation

Entities may not have considered events of default, insolvency or bankruptcy in their assessment of the offsetting rules or may have only considered the counterparty rather than all parties to the arrangement. Therefore, entities may need to reconsider their existing arrangements to determine whether items currently being offset would qualify for such a presentation under the amended guidance. This reconsideration may include new or revised legal opinions.

Meaning of 'simultaneous realisation and settlement'

The amendments provide clarification on which settlement processes would meet the requirement for offsetting that an entity has 'the intention to settle a financial asset and a financial liability net or simultaneously'. The realisation of a financial asset and settlement of a financial liability is simultaneous if the settlements occur 'at the same moment'. However, gross settlement that does not occur simultaneously may also meet the principle and criteria for offsetting if a single settlement process results in cash flows being equivalent to a single net amount. Specifically, a gross settlement system would meet the criteria for net settlement if it has all of the following characteristics:

- financial assets and financial liabilities that meet the right of set-off criterion are submitted for processing at exactly the same point;
- once the financial assets and liabilities are submitted for processing, the settlement instructions cannot be cancelled or altered;
- there is no potential for the cash flows arising from the assets and liabilities to change once they have been submitted for processing unless the processing fails;
- if the processing of one asset or liability that is offset against another fails, then the processing of the related security used as collateral will also fail (and vice versa);
- any transactions that fail will be re-entered for processing until they are settled;
- settlement of the amount due and payable is carried out through the same settlement institution (for example, delivery versus payment or the same depository account); and
- there exists an intraday credit facility that will provide sufficient overdraft or other intraday credit at the settlement date for each of the parties, and there is a high likelihood that the intraday credit facility would be honoured if called upon.

Effective date and transition

The amended offsetting disclosures are required for annual periods beginning on or after 1 January 2013 and interim periods within those annual periods. The disclosures should also be provided retrospectively for all comparative periods. However, the clarifying amendments to IAS 32 are not effective until annual periods beginning on or after 1 January 2014, also with retrospective application required.

Observation

The IASB had originally decided on an effective date of 1 January 2013 for both the disclosures in IFRS 7 and clarifying amendments to IAS 32. However, constituents raised operational concerns with the clarifying amendments to IAS 32. In particular, they noted the requirement to provide comparative information as of 1 January 2012, the fact that many of their contractual arrangements will have to be reconsidered and that systems changes may be required. Based on these concerns, the Board decided to delay the effective date of the clarifying amendments to annual periods beginning on or after 1 January 2014.

Key contacts

IFRS global office

Global Managing Director, IFRS Clients and Markets

Joel Osnos

ifrglobalofficeuk@deloitte.co.uk

Global Managing Director, IFRS Technical

Veronica Poole

ifrglobalofficeuk@deloitte.co.uk

Global IFRS Communications

Randall Sogoloff

ifrglobalofficeuk@deloitte.co.uk

IFRS centres of excellence

Americas

Canada

Karen Higgins

iasplus@deloitte.ca

LATCO

Fermin del Valle

iasplus-LATCO@deloitte.com

United States

Robert Uhl

iasplusamericas@deloitte.com

Asia-Pacific

Australia

Anna Crawford

iasplus@deloitte.com.au

China

Stephen Taylor

iasplus@deloitte.com.hk

Japan

Shinya Iwasaki

iasplus-tokyo@tohmatsu.co.jp

Singapore

Shariq Barmaky

iasplus-sg@deloitte.com

Europe-Africa

Belgium

Laurent Boxus

BEIFRSBelgium@deloitte.com

Denmark

Jan Peter Larsen

dk_iasplus@deloitte.dk

France

Laurence Rivat

iasplus@deloitte.fr

Germany

Andreas Barckow

iasplus@deloitte.de

Luxembourg

Eddy Termaten

luiasplus@deloitte.lu

Netherlands

Ralph ter Hoeven

iasplus@deloitte.nl

Russia

Michael Raikhman

iasplus@deloitte.ru

South Africa

Graeme Berry

iasplus@deloitte.co.za

Spain

Cleber Custodio

iasplus@deloitte.es

United Kingdom

Elizabeth Chrispin

iasplus@deloitte.co.uk

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