Project	**Offsetting of financial assets and liabilities**
Topic	**Description of and the interaction of the factors**

Background

1. At the September 2010 meeting, the boards discussed the appropriateness of offsetting of financial assets and liabilities, in the context of their respective, and now final joint conceptual frameworks. The Boards also discussed a staff paper summarising the feedback from users on the usefulness of offsetting.

2. The Boards concluded that the following factors may be helpful in determining when offsetting provides useful information on the face of the statement of financial position or in the notes:
   (a) whether the parties need to have the ability to offset or settle net
   (b) whether the parties need to demonstrate an intent to settle net
   (c) whether the amounts owed under the respective contracts ought to be settled on the same date or be settled simultaneously
   (d) whether the financial asset and liability ought to have the same maturity
   (e) whether the financial asset and liability ought to have the same underlying risk
   (f) whether offsetting should be on the basis of bilateral or multilateral netting arrangements.

Purpose of this Paper

This paper has been prepared by the technical staff of the IFRS Foundation and the FASB for discussion at a public meeting of the FASB or the IASB.

The views expressed in this paper are those of the staff preparing the paper. They do not purport to represent the views of any individual members of the FASB or the IASB.

Comments made in relation to the application of U.S. GAAP or IFRSs do not purport to be acceptable or unacceptable application of U.S. GAAP or IFRSs.

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3. This paper :

   (a) describes each of the factors mentioned in paragraph 2;

   (b) discusses possible interactions among the factors; and

   (c) sets out a framework for analysing the usefulness of offsetting and seeks the Boards views on usefulness of offsetting in light of that framework.

Description of factors

(a) Factor 1 - whether the parties need to have the ability to offset or settle net

4. They key questions here are:

   a. Whether the parties need to have the ability to offset or settle net and if so

   b. Whether that right should be unconditional (ie in the normal course of business) or can be conditional (ie the offset right is enforceable in default or similar circumstances)

5. The right of set-off is a debtor's legal right, by contract or otherwise, to settle or otherwise eliminate all or a portion of an amount due to a creditor by applying against that amount an amount due from the creditor.

6. Some rights to offset affect directly the rights and obligations associated with a financial asset and a financial liability (eg novation netting amalgamates existing contracts into a single contract) whilst other rights of offset do not affect directly the rights and obligations inherent in the respective contracts.

7. Rights to offset that affect directly the rights and obligations associated with a financial asset and a financial liability, for purposes of offset and in accounting in general, are perceived primarily as a unit of account question.

8. On the other hand, a right of offset that does not affect the rights and obligations directly, such as contractual mechanisms enabling termination of a financial contract in the case of a bankruptcy and provides for netting of payments due under multiple contracts, is seen primarily to be a credit risk issue (ie a means of managing the credit risk of the parties to the contracts).

Should the offset model require a right of offset?

9. Both US GAAP and IFRS guidance on offsetting require a right of setoff. However, some transactions or industries may not have structures such as master netting agreements but some of those transactions may raise questions about offset.

10. For example, telecom operators do enter into interconnect agreements with other carriers. These agreements allow them to terminate or transit traffic on their respective networks. Interconnect agreements usually allow carriers to settle on a net basis. However, an operator may bear the gross credit risk for non-payment and be obliged to make payments under interconnect arrangements, irrespective of the level of reciprocal revenues due. Some operators reduce their exposure to other carriers by entering into agreements that give them the legal right to offset.

11. Telecom carriers also frequently enter into arrangements where the rates and amount of traffic to be carried by each party are established upfront. The entities in such cases may agree to exchange services with the likelihood of any net cash settlement being remote. For example, carriers A and B may have traditionally terminated relatively similar amounts of traffic on each other's network with typically only a small net settlement required each month. The carriers may then enter into an agreement to terminate up to a specific number of minutes on each others network with only minutes above these amounts being settled in cash. Hence there may not be a legal right to offset.

12. Positions (receivables and payables) created under these contracts would in many cases qualify as financial assets and liabilities.

13. Some argue that the existence of an enforceable right to set off a financial asset and a financial liability affects the rights and obligations associated with a financial asset and financial liability (and may affect an entity's exposure to credit and liquidity risk). They also argue that, in the absence of a right of offset, the rights and obligations underlying each individual financial asset and liability are not altered and hence in the absence of a right of offset, such instruments should not be presented net.

Conditional versus unconditional rights to offset

14. The right of offset may either be unconditional or conditional.

15. On a conceptual level, the difference between conditional and unconditional is that conditional right of offset focuses on expected outcome in the event of default or termination of the contract (worse case scenario) whereas unconditional right of offset focuses on circumstances that are expected to arise in the normal course of business (which may include default but only when it has occurred or is expected to).

16. An example of an unconditional right of offset is payment netting. Under payment netting provisions, both contracting parties undertake to accept the net performance of the other party. Payment netting may apply in specified circumstances, such as amounts or deliveries due on the same date or payments that are in the same currency or are the same asset. Section 2 of the ISDA Master Agreement, entitled "Obligations", addresses payment offset. This provision ensures **automatic offset** of each party's obligation to make payments (automatic satisfaction and discharge) and replacement with an obligation to make payment or a right to receive payment of the net sum. This provision may be applied to cash flows resulting from multiple transactions where payments occur on the same date and in the same currency, if parties so elect in the schedule or in the confirmation.

17. Close-out netting is an example of a conditional right of set off. Close-out netting is a contractual mechanism, that may enable unilateral termination of a financial contract (or financial contracts governed by a master agreement), in the case of a bankruptcy or other event stipulated in the agreement, and at the same time the netting of their replacement values into a final balance, usually referred to as the "termination amount". The cost of the replacement of individual positions in such transactions by new ones is determined, taking account of market prices. The market price set in this manner is then converted into one currency and the net position established. A net payment is then made at this time. The party that is out-of the-money may be obligated under the master agreement to pay the net amount to the in-the money party, regardless of who is the defaulting party. Sections 5, 6

and 9 of the ISDA Master Agreement set out a detailed mechanism for close-out netting under the ISDA Framework.

18. Conditional right to set off recognised amounts, such as close-out netting in a master netting agreement or in some forms of non-recourse debt, are enforceable only on the occurrence of some future event, usually a default of the counterparty. Thus a conditional right to offset provides information about the maximum exposure to loss (arising from counterparty risk) with respect to some financial contracts (such as derivative contracts). Hence some argue that offset based on conditional right to offset provides useful information to users of financial statements.

19. Others argue that conditional right of set-off is appropriate only when default has occurred.

20. They reason that unconditional right to set-off should not be included in an offsetting model because the statement of financial position is intended to present assets and liabilities, and not merely a summary based on net risks.

21. Moreover, they argue that financial statements are prepared on the assumption that the reporting entity is a going concern and would continue in operation and thus it is assumed that the entity has neither the intention nor the need to liquidate or curtail materially the scale of its operations. If such an intention or need exists, the financial statements may have to be prepared on a different basis.

(b) Factor 2 - whether the parties need to demonstrate an intent to settle net

22. In practice, intention to offset may be demonstrated through management representations that are not contradicted by past experience or other relevant circumstances and, also, may take into account reference to the entity's risk management policies.

23. An entity's intentions with respect to settlement of particular assets and liabilities may be influenced by its normal operating practices, the requirements of the financial markets, and other circumstances that may limit the ability to settle net.

The requirement for an assessment of intent is, however, considered only from the reporting entity's perspective.

24. Some contracts and master agreements provide for **automatic offset** of payments due on the same day and in the same currency. With such an agreement it is doubtful whether demonstration of intent is necessary and some may argue that that intention was demonstrated when entering the contracts.

25. In a centrally cleared derivatives market with a central counterparty (CCP), the rules of the clearinghouse typically provide for the automatic netting and cancellation of offsetting contracts. Thus, market participants can easily exit positions by entering into an offsetting trade with the CCP.

(c) Factor 3 - whether the amounts owed under the respective contracts ought to be settled on the same date or be settled simultaneously

26. The following key questions need to be addressed in considering whether this factor should be incorporated into the offsetting model:

    a. Form of the settlement (one way payment by way of a net amount or multiple gross payments)

    b. Should credit risk have been eliminated (or arrangement to mitigate credit risk)?

    c. What is the acceptable time difference between payments (same day, irrespective of time, or simultaneously?)

27. Same date settlement is a straightforward concept. Two or more contracts, with the same or different underlying risks or maturity profiles may settle (either terminate or generate interim payments) on the same date. This is usually referred to as same date/day settlement. Such contracts may not allow for a net payment and hence multiple payments or cheques would have to be effected by the parties involved.

28. Simultaneous settlement ('to realise an asset and settle a liability simultaneously') is an idea which was introduced by IAS 32. IAS 32, however, does not define the term but provides some explanation as to what qualifies as simultaneous.

29. IAS 32, paragraph 48, specifies that – 'Simultaneous settlement of two financial instruments may occur through, for example, the operation of a clearing house in an

organised financial market or a face-to-face exchange. In these circumstances the cash flows are, in effect, equivalent to a single net amount and there is no exposure to credit or liquidity risk. In other circumstances, an entity may settle two instruments by receiving and paying separate amounts, becoming exposed to credit risk for the full amount of the asset or liquidity risk for the full amount of the liability. Such risk exposures may be significant even though relatively brief. **Accordingly, realisation of an asset and settlement of a liability are considered simultaneous only when the transactions occur at the same moment**.

30. The staff notes that the standard does not define 'same moment'.

31. Staff research indicates that in practice, if the instruction of transaction is simultaneous but, due to processing constraints, actual settlement takes place over a settlement period, and over this period there is no potential for any movement in the value of the transactions (ie no exposure to market changes and no exposure to loss from any other sources); this is regarded as simultaneous settlement. On the other hand, realisation and settlement of an asset and a liability at the same nominal time but in different time zones is not considered to amount to simultaneous settlement.

32. Additionally, where there are different maturity dates, the parties would not be considered to be in a position to realise the asset and liability simultaneously. Surprisingly, some take the view that where premiums on opposing option contracts are settled on the same date, by virtue of the continuing exposure to credit risk on one or both parties, this condition will not be met.

33. It appears that the simultaneous settlement requirement is only met if the contracts are settled at the same moment or same date and there is absence of any exposure to credit risk between the settlement of the two contracts. The cash flows under a simultaneous settlement (that is settlement at the same moment) are seen to be effectively equivalent to a single net amount.

No gross settlement should qualify for offsetting

34. This option is based on the view that the form of the settlement (or the actual cash flows) matter. Under this option, any gross settlements which involve two payments between the parties should not qualify for offsetting, irrespective of the length of time between the two payments (even when they occur at the same moment).

35. Some would argue that this option faithfully represents the actual cash flows of the transaction.

36. However, it could be argued that the net amount would provide useful information to users if payments between the parties are expected to be settled simultaneously or within a reasonably short time.

Simultaneous settlement should qualify offsetting

37. This option reflects the view that offsetting should be allowed for gross settlement when the transactions occur at the same moment because there is no exposure to credit or liquidity risk in that case. IAS 32 takes this approach.

Simultaneous settlement and settlement on the same date (only with credit risk mitigation)

38. Under this alternative, gross settlements qualify for offsetting, if (i) the payments occur on the same date or simultaneously and (ii) some arrangements for credit risk mitigation are provided as part of the transaction.

39. Some would argue that credit risk inherent in a transaction is the most important element in terms of offsetting and thus financial assets and liabilities should be presented net as long as a particular level of arrangement for credit risk mitigation (eg, collateral requirements) is provided under the transaction.

40. If this option is adopted, the boards would need to determine the required level of credit risk mitigation.

Simultaneous settlement and settlement on the same date (without credit risk mitigation)

41. Under this view, settlements on the same date (irrespective of time difference) should qualify for offsetting even without any credit risk mitigation arrangements.

42. Some would argue that entities usually manage credit and liquidity risk based on the date of the settlement. Others may argue that in cases where credit risk is present, it will already be reflected in the measurement of the item and there might not be any need to use credit risk as a basis for offset.

(d) Factor 4 - whether the financial asset and liability ought to have the same maturity

43. This issue is whether the two instruments should have the same contractual maturity to qualify for offsetting.

44. Maturity generally refers to the date at which legal rights in a contract fall due. In the context of financial instruments, maturity can either be

    a. the end of the period covered by a contract; ie the term or life of a financial instrument that is fixed at the time it is issued (original maturity) or

    b. the period of time until the redemption or expiration of a financial instrument (remaining maturity) or

    c. the date a payment is due under the contract.

45. The staff notes the complexity of the distinction in practice (due to rollovers, early termination options etc). Some instruments, such as tranched notes and swaps, may consist of several obligations of different maturities or payment dates.

46. The issue therefore is which of the different usages of maturity is useful in the context of offsetting; ie should offsetting be based on original or remaining maturity.

47. Payment date has already been addressed under the first factor (ie whether the amounts owed under the respective contracts ought to be settled on the same date or be settled simultaneously) and hence we can assume it is not what is meant by maturity.

48. Original term to maturity concept is useful for classifying financial instruments in broad terms. However, it will be more useful to base offset on the time remaining until extinguishment of the liability or asset (ie remaining maturity basis). Those interested in leverage and liquidity may prefer information based on remaining

maturity rather than original maturity. Remaining maturity approach will be consistent with how assets and liabilities are presented, in general, in the statement of financial position under both IFRS and US GAAP. Hence we have used remaining maturity for the analysis under this section.

The same maturity should be required to qualify for offsetting

49. This factor - 'same maturity' - may play an important role if the boards were to decide *not* to adopt 'intent' as part of the model for offsetting. For example, under US GAAP exception to repo transactions (in which 'intent' is not required) this condition is required as part of offsetting criteria[1].

The same maturity should not be required

50. This option is based on the view that basing offset on the 'same maturity' would be unreasonably restrictive as it would prevent an entity from offsetting instruments when it intends to settle the instruments net on a date which differs from the original maturity date. For example, an entity may accept a delayed payment from its counterparty to settle an obligation to the same counterparty due at a later date. In other words, this factor could override the 'intent' factor.

51. In addition, even if the 'intent' factor is not adopted under the offsetting model, it would be redundant to have this factor - 'same maturity' - if contracts are required to be settled net, simultaneously or on the same date, as part of the model (see discussion in the previous section).

(e) Factor 5 - whether the financial asset and liability ought to have the same underlying risk [2]

52. Risk underlying a particular financial instrument may be one or more of the following[3]:

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[1] The repurchase and reverse repurchase agreements are required to have the same explicit settlement date specified at the inception of the agreement (FASB ASC 210-20-45-11 (b)).

[2] These factors are explained in detail in Agenda Paper 8C (September 2010 meeting).

[3] IFRS 7, *Financial Instruments: Disclosures*, Appendix A.

a. **Market risk** is the risk that the fair value or future cash flows of a financial instrument will fluctuate because of changes in market prices (including currency risk, interest rate risk and other price risk).

b. **Credit risk** is the risk that one party to a financial instrument will cause a financial loss for the other party by failing to discharge an obligation.

c. **Liquidity risk** is the risk that an entity will encounter difficulty in meeting obligations associated with financial liabilities that are settled by delivering cash or another financial asset.

53. Credit (counterparty) risk is addressed separately under ‘bilateral or multilateral netting arrangements’ and ‘ability to settle net’ and hence does not form part of the analysis under this factor. Similarly, liquidity risk is addressed under maturity and settlement dates and hence would not be addressed under this factor.

54. This issue is therefore whether to require the asset and the liability to have the same, similar, identical or substantially the same underlying market risk(s) (eg, interest rate risk, currency risk, commodity risk and so on).

The asset and the liability should have identical underlying risks

55. This option reflects the view that information about some of the risk exposures derived from the instruments are inevitably obscured on the face of the statement of financial position unless the instruments to be offset have identical underlying risks.

56. ‘Identical risks’ requirement would, generally, be satisfied only when an entity has a contract that is an exact opposite of the other contract (eg, when an entity has entered into several forward contracts to buy and sell the same T-bonds).

57. It should be noted that this factor is not currently required under the existing offsetting models in IFRS or US GAAP.

58. This option is consistent with how most exchanges treat many positions with their members. In general, exchanges (i) offset positions in a particular product (by book entry) or (ii) net by novation outstanding contracts into a single contract at the end

of a trading date or period, if the contracts are of the same type (risk, duration, currency etc)[4].

The asset and the liability should have the same primary risk

59. Under this option, the asset and the liability qualify for offsetting if they share the same *primary* risk. This reflects the view that, in managing risk exposures in practice, entities usually enter into contracts which have similar but not identical risks to those outstanding.

60. The staff notes that information about the *non-primary* risk exposures would be obscured under this option. In addition, it would be difficult to identify one primary underlying risk because financial instruments, especially in the case of derivatives, are usually exposed to several different types of risk.

61. Offsetting on the basis of the same primary risk ignores the other risks that may be present in financial assets and liabilities. For example, two interest rate swaps may not react the same way to changes in economic factors if the floating leg is based on different indices, such as the London Interbank Offered Rate and the Euro Interbank Offered Rate.

62. Further, a single financial asset or financial liability may have many risks and it may be difficult to identify one primary underlying risk. For example, a forward on equity securities has stock price and foreign currency exchange risk. This may cause operational difficulties for entities because they would have to determine the primary or predominant risk of every financial asset and financial liability to determine which items should be offset in the balance sheet. Furthermore, even if financial assets and financial liabilities are offset based on primary underlying risks, other risks present in the financial assets and financial liabilities could potentially be obscured.

[4] It should be noted that in the case of 'netting by novation' there is no offsetting issue in accounting in terms of that particular type of instrument because an entity always has one single contract with its counterparty.

Same market risk should not be required

63. This option is based on the view that credit risk (in the normal course of business/in the event of default) should be the basis for offsetting on the face of the statement of financial position.

64. Proponents of this option note that, at present, instruments with different risk exposures are aggregated into a specific line item on the face of the statement of financial position (ie, some of the risk exposures are already obscured). Hence, they argue that footnote disclosures should rather be used to supplement information about non credit risk exposures.

65. It is true that at present various instruments are aggregated into one line item on the face of financial statements and this masks some of the characteristics of instruments included in that line item (eg, several different types derivative assets may be aggregated and presented as 'Derivative assets').

66. However, it should be noted that the offsetting is different from the issue of aggregation. Offsetting by its nature (i) changes the size of the statement of financial position (affecting primary financial indicators such as leverage ratios) and (ii) obscures the *existence* of some instruments on the face of the statement of financial position.

67. Also this approach would not reflect an entity's net credit risk exposure if financial assets and financial liabilities with different counterparties are offset. Such an approach could produce misleading information because an entity's exposure to credit risk may be much larger than the net amount presented on the balance sheet.

(f) Factor 6 - whether offsetting should be on the basis of bilateral or multilateral netting arrangements

68. The issue here is whether to limit offsetting only to the case where an entity has an asset and a liability with the same counterparty (bilateral) or to allow offsetting for arrangements where more than two parties are involved (multilateral).

69. US GAAP allows offset only for contracts between two parties. IAS 32, on the other hand specifies that 'in unusual circumstances, a debtor may have a legal right

to apply an amount due from a third party against the amount due to a creditor provided that there is an agreement between the three parties that clearly establishes the debtor's right of set-off'.

70. For example, a foreign branch of a US bank makes a loan to a foreign subsidiary of a US parent with the parent required to deposit an amount equal to the loan in the US bank for the same term. The bank has legal set off by the foreign subsidiary.

71. Another example is bank accounts maintained for a group of companies where each member of the group agrees that its credit balance may be the subject of set-off in respect of debit balances of other members of the group.

72. Instances of similar arrangements go beyond group scenarios:

- The IATA has set up a clearing house system by which sums due from member airlines to each other is netted out each month, remittances being sent by IATA to airlines having net credit balance and collected from airlines with a net debit balance. In some of these structures, IATA may act as a principal or an agent of the participants (in providing a clearing mechanism). If IATA acts a principal, then the contracts are bilateral in nature (ie between IATA and the individual members). On the other hand if the scheme is drafted such that it acts as an agent, then it is a multi party agreement (which may have members ranging from 2 to infinity).

Only bilateral netting should qualify for offsetting

73. This option reflects the view that offsetting based on multilateral arrangements does not faithfully represent the credit risk an entity is exposed to.

74. In addition, some would argue that it is difficult to satisfy all the other factors, including legally enforceable right to offset (if adopted), under multilateral arrangements. They argue that, as stated in IAS32, there may be cases where multilateral agreement meets the intent and ability to offset criteria but those cases are 'unusual circumstances.'

Multilateral netting should also qualify for offsetting

75. This option reflects the view that there is no strong reason to explicitly exclude multilateral netting arrangements from the scope of offsetting if all the other criteria, including legal enforceability are met for the transaction.

76. In addition, there may be unintended consequences in practice if offsetting is limited to bilateral arrangements because multilateral netting arrangements are currently eligible for offsetting under IAS32.

Interaction of factors

77. Now that there is a common understanding of the factors. The staff has identified the following interaction of the factors for the boards' consideration. As discussed earlier, the six factors are:
    (a) Factor 1- whether the parties need to have the ability to offset or settle net
    (b) Factor 2- whether the parties need to demonstrate an intent to settle net
    (c) Factor 3- whether the amounts owed under the respective contracts ought to be settled on the same date or be settled simultaneously
    (d) Factor 4- whether the financial asset and liability ought to have the same maturity
    (e) Factor 5- whether the financial asset and liability ought to have the same underlying risk
    (f) Factor 6- whether offsetting should be on the basis of bilateral or multilateral netting arrangements.

Factor 1: Ability to offset

78. There is some interaction between ability to offset (Factor 1) and the following factors:
    a. Intent to offset (Factor 2)
    b. Same date or simultaneous settlement (Factor 3)
    c. Maturity (Factor 4)

79. Some argue that if an entity has an unconditional right of offset and an intention to offset, offsetting reflects an entity's expected future cash flows from settling two or more separate financial instruments. They note that the existence of the right, by itself, is not a sufficient basis for offset because the amount and timing of an entity's future cash flows may not be affected.

80. They argue that when an entity does intend to exercise the right, presentation of the asset and liability on a net basis reflects more appropriately the amounts and timing of the expected future cash flows, as well as the risks to which those cash flows are exposed.

81. However, others argue that the right to set off may of itself be a sufficient condition for presenting net a financial asset and a financial liability. If a right of setoff is currently enforceable, the financial asset and financial liability together may be seen as forming a single asset or liability regardless of how the parties intend to settle the two positions. Also, intention to settle net is subjective and difficult to substantiate. It also begs the question why any party with a right of set off would prefer to make and receive gross amounts (if the amounts outstanding are in the same currency and fall due on the same date).

82. Same date/simultaneous settlement or same maturity date (Factor 4) would suggest ability to offset is not a necessary criterion. If contracts settle on the same date for example, then whether a party has the ability to settle net or not may be a redundant requirement. For example, when payments are contractually required and thus reasonably expected to be settled net or settled on the same date, the entity's ability to settle net may no longer be a critical factor. However, without ability to offset, the entity will be exposed to the credit risk of the counterparty.

Factor 2: Intent to offset

83. The staff believes there are interactions between the intent to offset factor and the following factors:

    a. Ability to offset (Factor 1)

    b. Same date or simultaneous settlement (Factor 3)

    c. Maturity (Factor 4)

84. If an asset and a liability or a payable and receivable fall due on the same date or will be settled simultaneously, it is difficult, at least in principle, to argue that intention is necessary. Baring insolvency of one or both parties, the asset and liability will settle on the same date or one will be liquidated to pay the other and hence the entities' net cash flow for that date will be the same as if a net payment is enforceable and intended. However the staff notes that cheques/payments may not always be honoured and hence intention to offset might be necessary.

85. There is close link between intent and ability to offset, same date/simultaneous settlement and maturity of the contracts. The interaction between intent and ability to offset and same date/simultaneous settlement is discussed in the previous section. The staff notes that if the maturity of the underlying contracts are the same (and particularly if they are payments in the same currency or represent delivery of the same underlyings) then netting would provide an indication of the net cash flows irrespective of demonstration of intent or not.

<u>Factor 3: Same day/date settlement or simultaneous settlement</u>

86. The staff believes there are interactions between the settlement factor and the following factors:

    a. Ability to offset (Factor 1)

    b. Intent to offset (Factor 2)

    c. Maturity (Factor 4)

87. Same date/simultaneous settlement would suggest intention to offset is not a necessary criterion. If contracts settle on the same date for example, then whether a party intends to settle net may be a redundant requirement. For example, when payments are contractually required and thus reasonably expected to be settled net or settled on the same date, the entity's intent to do so may no longer be a critical factor.

88. Some might also argue that the same logic apply even in the absence of ability to offset. However, without ability to offset, the entity will be exposed to the credit risk of the counterparty.

89. If this factor is included in an offsetting model, it is difficult to see any need to consider maturity. If the instruments settle on the same date or simultaneously, one can argue that they have the same remaining maturity and even if they don't this approach will still provide a good indication of the amount and timing of future cash flows.

Factor 4: Maturity Interactions

90. The staff believes there are interactions between the settlement factor and the following factors:

    a. Ability to offset (Factor 1)

    b. Intent to offset (Factor 2)

    c. Settlement (Factor 3)

91. Same as in Factor 3 (same date/simultaneous settlement). See preceding section discussing those interactions.

Factor 5: Risk Interactions

92. Although this factor on its own does not provide useful information to users of financial statements, it will provide very useful information when combined with the following factors:

    a. Ability to offset (Factor 1)

    b. Settlement (Factor 3)

    c. Maturity (Factor 4)

Usefulness of offsetting

93. The staff papers for the September 2010 meeting addressed the usefulness and appropriateness of offsetting, in general, in the context of the boards' *Conceptual Frameworks.*

94. At this meeting, the staff would like to seek the Boards views on what useful information might be provided by use of each of the factors in paragraph 2. To allow for a focused discussion and in providing feedback, we would like the Board

to have consideration for how offsetting may impact or provide useful information about the following:

(a) the timing, amount and uncertainty of future cash flows;

(b) the financial position of an entity (economic resources it controls and its financial structure);

(c) an entity's liquidity and solvency position; and

(d) the risks an entity is exposed to (apart from liquidity and credit risks)

95. In addressing this issue, the staff would like to draw the Boards attention to the general approach to offsetting under IFRS and US GAAP.

96. Paragraphs 32 and 33 of IAS 1 *Present of Financial Statements* state –

"An entity shall not offset assets and liabilities or income and expenses, unless required or permitted by an IFRS. (paragraph 32)

"An entity reports separately both assets and liabilities, and income and expenses. Offsetting in the statements of comprehensive income or financial position or in the separate income statement (if presented), except when offsetting reflects the substance of the transaction or other event, detracts from the ability of users both to understand the transactions, other events and conditions that have occurred and to assess the entity's future cash flows. Measuring asset net of valuation allowances – for example, obsolescence allowances on inventories and doubtful debts allowances on receivables – is not offsetting. (paragraph 33)

97. Paragraph 5 of FASB Interpretation No. 39 *Offsetting of Amounts Related to Certain Contracts* also states, partly, that – "Opinion 10, paragraph 7, states that "it is a general principle of accounting that the offsetting of assets and liabilities in the balance sheet is improper except where a right of setoff exists".

Question for the boards
The staff is seeking the Boards feedback on how offsetting may impact or provide useful information about the metrics set out in paragraph 94.