Project	**Offsetting Financial Assets and Liabilities**
Topic	**Disclosures - Alternatives**

Introduction/Purpose of the paper

1. At the June 14, 2011 joint board meeting, the boards discussed alternative approaches for offsetting financial assets and financial liabilities in the statement of financial position. The boards considered the following alternative approaches to offsetting:

   (a) **Alternative 1**—This approach requires an unconditional right of set-off that is legally enforceable both in the normal course of business and in bankruptcy, insolvency, or default and intention to settle a financial asset and financial liability net or simultaneously.

   (b) **Alternative 2**—This approach requires offset if an entity currently has a legally enforceable right to set-off a financial asset and financial liability and the entity intends to settle the financial asset and financial liability net or simultaneously.

   (c) **Alternative 3**—This approach provides an exception from the general offsetting criteria for derivative instruments and allows offsetting of fair value amounts recognized for derivatives and fair value amounts recognized for the right to reclaim cash collateral or the obligation to return cash collateral arising from derivative instrument(s) recognized at fair value with the same counterparty under a master netting agreement. This approach requires a right of set-off that is only enforceable in bankruptcy, insolvency, or default of one of the counterparties.

      (i) Alternative 3a—This approach limits the exception for offsetting of derivative instruments under Alternative 3 to only collateralized derivatives with daily variation margin postings.

2. The IASB voted in favour of an offsetting model based on an unconditional right and intention to offset **(Alternative 1).** The FASB voted in favour of an approach that allows offset of derivative instruments if an entity has a conditional right of set-off (**Alternative 3**).

3. The boards also noted that users consistently asked that both gross and net information be provided and that information be provided to help reconcile any differences in the offsetting requirements for IFRSs and US GAAP. The boards therefore decided to work on converging disclosure requirements to assist users in comparing financial statements prepared in accordance with IFRSs and US GAAP.

4. Following the boards' decision in June 2011, the staff has identified two alternative sets of disclosure requirements for the boards' consideration.

5. This paper describes those disclosure alternatives. The staff recommendation reflects the boards' decision and the feedback received on the proposals in the ED.

Disclosure Alternatives

6. Following the recent decisions by the boards and the feedback received on the disclosure requirements in the ED, the staff has identified the following alternative sets of disclosure requirements for the boards' consideration:

   (a) **Alternative A**: Reconciliation of amounts presented in the statement of financial position to the gross amounts of financial instruments.

   (b) **Alternative B**: Disclosure of :

      (i) the gross amounts;

      (ii) the amounts presented in the statement of financial position;

      (iii) any other amounts that can be offset in the event of bankruptcy, insolvency or default of any of the parties (including cash and non-cash financial collateral) and

(iv) the entity's net exposure (the amounts in (ii) less the amounts in (iii).

7. Both of the alternatives identified above are based on the disclosure objective of providing users with information about both gross and net amounts, information on the effect of rights of set-off on the entity's financial position and information to assist users in comparing financial statements prepared in accordance with US GAAP with those prepared in accordance with IFRSs. However, the type of information required to be disclosed would vary depending on the alternative selected.

8. The staff recommends that, whichever alternative the boards choose, the respective illustrative disclosure included in this paper should be included in the final standard.

Alternative A: Reconciliation of amounts presented in the statement of financial position to the gross amounts

9. This approach would require an entity to reconcile amounts presented in an entity's statement of financial position (based on the relevant offsetting guidance) to the gross asset and liability amounts. This would provide users with comparative information about gross balances and help them understand the extent of netting that is achieved in the statement of financial position.

Disclosure requirements

10. Consistent with the objective stated in paragraph 7, this approach would require entities to disclose the following:

(a) the gross amounts of their financial assets and financial liabilities,

(b) the amounts of financial assets and financial liabilities offset in the statement of financial position and

(c) the net amount after taking into account (a) and (b), which should be the same as the amounts reported in the statement of financial position.

11. An illustrative example of this disclosure is as follows. Entities would be required to provide, separately, the same information for both financial assets and financial liabilities.

Category	Gross amount	Amount offset in the statement of financial position	Amount in statement of financial position
	A	**B**	**C=A-B**
Derivatives			
Reverse repurchase, securities borrowing and similar arrangements			
Other financial instruments			

Analysis

12. This approach not only gives users information about an entity's gross and net amounts, but it also allows users to compare the gross amounts (positions) of entities reporting in accordance with IFRSs and US GAAP. This approach is similar to what is currently required under US GAAP for derivatives in Topic 815.

13. From a cost perspective, this alternative would be the least expensive and would require the same level of effort in terms of compliance for both IFRS and US GAAP preparers. It allows for consistent comparison of the gross amounts (positions) between US GAAP and IFRS preparers, but it may fall short of the needs of financial statement users by not providing them with information about the effect of rights of conditional set-off and collateral if they are not already included in the net amount in the statement of financial position.

Alternative B: Disclosure of (i) gross amounts, (ii) the amounts presented in the statement of financial position, (iii) any other amounts that can be offset

in the event of bankruptcy, insolvency or default of any of the parties and (iv) the net position.

14. Similar to Alternative A, this approach would require an entity to disclose the gross amounts of financial assets and financial liabilities as well as the amounts presented in the statement of financial position.

15. However, entities would also be required to disclose the net amount after taking into account the effect of rights of set-off that are enforceable and exercisable in bankruptcy, default or insolvency of either party (that have not been taken into account in arriving at the amounts shown in the statement of financial position). Such rights would include cash and non-cash financial collateral.

Disclosure requirements

16. Consistent with the objective set out in paragraph 7, this approach would require entities to disclose the following:

    (a) the gross amounts of financial assets and financial liabilities,

    (b) the amounts of financial assets and financial liabilities offset in the statement of financial position,

    (c) the net amount after taking in account (a) and (b), (which should be the same as the amounts reported in the statement of financial position),

    (d) the effect of rights of set-off that are only enforceable and exercisable in bankruptcy, default or insolvency of either party not taken into account in arriving at the amounts presented in the statement of financial position (including collateral) and

    (e) the net exposure after taking into account the effect of items in (b) and (d).

17. Entities would be required to provide, separately, the same information for both financial assets and financial liabilities.

18. Many preparers were concerned with the benefit of providing the conditional or collateral information by type of financial instrument compared with the

cost of providing such information (paragraph 16(d)). They argued that they manage exposure by counterparty and not by type of financial instrument and that providing this information by counterparty would be aligned with their risk management activities.

19. The majority of users indicated that provision of collateral and conditional set-off information (not already offset in the statement of financial position) by either counterparty or by type of financial instrument would also be useful.

20. Providing flexibility as to how the required information may be presented would facilitate management communication with users of financial statements.

21. As a result, the staff recommends that this Alternative provide an entity with a choice of disclosing the information required by paragraph 16 (d) by major type of financial instrument and/or by counterparty.

22. An illustrative example of this disclosure by type of financial instruments is as follows:

Category	**Gross amount**	**Amount offset**	**Amount in statement of financial position**	**Amount available to be offset in bankruptcy or default (not netted in the statement of financial position)**		**Net credit exposure**
				Financial instruments	**Collateral**	
	A	**B**	**C=A-B**	**D**	**E**	**F= C-D-E**
Derivatives						
Reverse repurchase, securities borrowing and similar arrangements						
Other financial instruments						

23. If an entity provides the required information in paragraph 16 (d) by counterparty, counterparties would not be identified by name, but the amounts related to individually significant counterparties would be separately disclosed and the remaining individually immaterial counterparties could be aggregated in one line in the table. An illustrative example of this disclosure is as follows:

Financial assets and related offsetting arrangements

CU million

As at 31 December 20XX	(i) Gross amount of financial assets	(ii) Gross amount of financial liabilities offset against financial assets in the statement of financial position	iii = (i-ii) Net amount of financial assets in the statement of financial position
Description			
Derivatives			
Reverse repurchase, securities borrowing and similar arrangements			
Other financial instruments			
Total			

Financial assets and related collateral received by counterparty

CU million				Collateral held	
As at 31 December 20XX	Net amount of financial assets in the statement of financial position	Gross amount of financial liabilities with rights of set off not subject to offset in the statement of financial position	Net amount of financial assets before collateral	Cash	Fair value of other financial instruments received as collateral
Counterparty A					
Counterparty B					
Counterparty C					
Counterparty D					
Counterparty E					
Other					
Total					

Analysis

24. This alternative reconciles the amounts presented in the statement of financial position (under the relevant offsetting guidance) to both gross amounts and an

overall net credit exposure amount, although the final 'net' column may not reconcile to amounts reported in the statement of financial position.

25. The amounts that would be included in (b) and (d) will be different depending on the applicable GAAP (as a result of the differences in the offsetting requirements – IFRS preparers would generally have more to disclose than US GAAP preparers) but the aggregate of those two items will be the same irrespective of the applicable offsetting guidance.

26. This alternative provides gross and net 'net' information on a comparable basis between IFRSs and US GAAP. Therefore, it may be considered responsive to requests from users of financial statements. Users have consistently communicated that both gross and net information is decision-useful. However, this alternative may not necessarily reconcile US GAAP and IFRS amounts.

Staff Recommendation

27. The staff recommends Alternative B as this approach is responsive to requests from financial statement users to have comparative information on both a gross and a net basis and is one of the key requests from users that prompted the offsetting project. There will be costs associated for the affected entities; however, the staff believes that the benefits associated with providing the comparable information to financial statement users outweigh such costs. In addition, through outreach conducted by the staff, the staff noted that such disclosures are more operational than those originally proposed in the ED.

Question for the boards
Do the boards agree with the staff recommendation in paragraph 27 to adopt Alternative B? If not, what do the boards propose instead?