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Project	Offsetting Financial Assets and Liabilities		
Topic	Additional feedback received		

Background

1. In March 2011, the IASB and the FASB published an exposure draft ('ED') proposing converged offsetting requirements for financial instruments and additional disclosure requirements relating to an entity's rights of set-off and the effects of such arrangements on an entity's financial position.
2. In June 2011 the boards decided not to pursue a common offsetting model but instead to develop converged offsetting disclosure requirements to assist users when analysing financial statements prepared in accordance with IFRSs and US GAAP.
3. Following the boards' preference for different offsetting approaches and hence the decision not to pursue a common offsetting model, the IASB also decided to retain the offsetting requirements in IAS 32 *Financial Instruments: Presentation*.
4. During the project, inconsistencies in the application of the IAS 32 offsetting requirements were highlighted, specifically around the meaning of the phrase 'currently has a legally enforceable right of set-off' and the treatment of some gross settlement systems that were not simultaneous. In September 2011 the IASB decided to address these inconsistencies by adding application guidance to IAS 32.

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

Comments made in relation to the application of an IFRS do not purport to be acceptable or unacceptable application of that IFRS—only the IFRS Interpretations Committee or the IASB can make such a determination.

The tentative decisions made by the IASB at its public meetings are reported in IASB *Update*. Official pronouncements of the IASB, including Discussion Papers, Exposure Drafts, IFRSs and Interpretations are published only after it has completed its full due process, including appropriate public consultation and formal voting procedures.

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Purpose

5. Subsequent to the Board's decisions in September 2011 the staff received feedback that clarifications to the IAS 32 application guidance may change practice for some entities. This is primarily due to:
 - (a) the clarification that a right of set-off must not only be legally enforceable right in the normal course of business, but that it must also be enforceable in the event of default and the event of insolvency or bankruptcy; and
 - (b) the clarification that a right of set-off must be legally enforceable for all parties (ie including the reporting entity).
6. While the proposed disclosure requirements are less onerous than those originally proposed in the ED, the staff also received feedback from IFRS constituents that the new converged disclosure requirements may cause additional burden to preparers.
7. The purpose of this paper is to inform the Board about additional feedback on the proposed effective date and transition that arose from clarifying the application guidance and finalising the converged disclosures. While the staff does not think it is necessary for the Board to reconsider its prior decisions on the effective date and transition of these items, the staff feels the Board should be aware of the feedback received. Therefore the staff would like the Board to confirm whether you agree that with the staff's analysis regarding this issue.

Feedback received

Application guidance

8. In September 2011 the Board clarified that in order to set off a recognised financial asset and a recognised financial liability in the statement of financial position, an entity must currently have a legally enforceable right of set-off (in addition to the intention to settle net or simultaneously). This means that the right of set-off must not be contingent on a future event, must be available for all of the counterparties (ie including the reporting entity itself) and in all of the following

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circumstances: the normal course of business, in the event of default and in the event of insolvency or bankruptcy.

9. The Board also decided that application guidance would be applied retrospectively and would be effective for annual and interim periods beginning on or after 1 January 2013.
10. Some respondents had not previously obtained assurance that the right of set-off was legally enforceable in the event of default and bankruptcy of their counterparty, themselves or both when applying the IAS 32 criteria. Some did not previously interpret IAS 32 as requiring that the right of set-off must be enforceable in the event of default and in the bankruptcy or insolvency of the counterparty. Some did not previously interpret IAS 32 as requiring that the right be enforceable in the event of the entity's own insolvency or bankruptcy.¹
11. Therefore these respondents have told the staff that it would be a burden to apply the clarifications to the application guidance for annual periods beginning on or after 1 January 2012 (ie the for the first comparative period) as they will have to go back and obtain additional evidence to offset in their statements of financial position. They argued this change could also impose an additional cost.
12. Some also believe the clarification may have a material (significant) impact on their statement of financial position as they may not be able to obtain such evidence for prior years and would therefore have to unwind previous amounts that had been offset in their statements of financial position. This could possibly trigger additional reporting requirements (ie presentation of as many as five years' comparative data) for some jurisdictions.

Disclosures

13. The ED required disclosure by class of financial instrument. The ED proposed that an entity provide the required information for any financial asset or financial liability subject to a right of set-off and/or for which the entity obtained or

¹ See Appendix B of Agenda Paper 5A/Memo 15A from the June 2011 joint meeting, and Agenda Paper 8A from the September 2011 IASB meeting.

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pledged cash or other financial instruments as collateral. The ED also proposed retrospective application and asked respondents how long they thought they would need to implement the proposed requirements.

14. Due to the scope and level of detail of the disclosures, comments on the proposed transition requirements and effective date varied. Some thought that the effective date should be later rather than sooner as they were concerned with the scope of the proposed disclosures. Some suggested that a substantial effort would be required to develop and implement systems to capture incremental contract-level data and requested an effective date no earlier than 2014. Others thought that January 2013 would be reasonable for either prospective or retrospective application.
15. In July 2011 the boards agreed on amended converged disclosure requirements to be applied retrospectively to annual and interim periods beginning on or after 1 January 2013. The requirements would only apply to financial instruments entered into under an enforceable master netting agreement or similar arrangement. Therefore the scope of the disclosures was reduced from that originally proposed in the ED. In addition, an entity would not be required to break out the information by individual class of financial instrument, and they would be given an option to disclose some information by counterparty.
16. While preparers supported the boards' view that retrospective application enhances consistency and comparability, many were concerned that the level of detail required in the disclosures would still be difficult to provide as it is not currently captured by systems.
17. Some IFRS constituents believe that an effective date of 1 January 2013 with retrospective application would be overly burdensome, in particular given the proposed issue date of the requirements in Q4 2011. While they may maintain information about rights of set-off in their risk management systems, to the extent that such rights do not meet the offsetting criteria in IAS 32 they may not have such information readily available in their financial reporting systems. In particular, some are concerned about the ability to determine collateral by class of

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financial instrument or by counterparty which is kept in credit rather than financial reporting systems.

18. However, others noted that while the effective date is in a short timeframe, they did not think that the burden is such that the date should be pushed back as they understand the need for comparable information.

Staff views

19. The original offsetting project was a result of requests from users to converge the offsetting requirements between IFRSs and US GAAP to increase comparability. In July 2011 the boards agreed on converged disclosures to help meet users' needs. However, in order for users of financial statements to benefit from the increased comparability the amended disclosures should be effective as early as possible. The boards noted that retrospective transition would maximise consistency of financial information between periods, and would facilitate analysis and understanding of comparative accounting data. In addition, the amended disclosures are less complex and have a narrower scope than those proposed in the ED.
20. In Agenda Paper 8C (September 2011) the staff recommended that the effective date of the disclosures should be as early as possible and recommended retrospective application for interim and annual periods beginning on or after 1 January 2013. The boards agreed.
21. The amendments to the IAS 32 application guidance clarify the Board's intentions with respect to the existing offsetting criteria in IAS 32. Based on this, and for consistency with the proposed effective date for the disclosure requirements, the staff recommended in Agenda Paper 8A (September 2011) that the amendments to the application guidance should be retrospectively applied and effective on the same date as the disclosure requirements (ie for annual and interim reporting periods beginning on or after 1 January 2013). The Board agreed.
22. Despite additional feedback received, the staff believes that the proposed effective date and transition are still appropriate considering the original reasons

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for the offsetting project, the needs of users of financial statements and the decisions the Board has made regarding the application guidance and the disclosures. The staff also notes that as we wish to align the application dates for the amendments IAS 32 and IFRS 7 any change to the dates would impact the disclosure requirements that are being amended jointly with the FASB. Only IFRS constituents have raised the concerns outlined in this paper. Therefore the staff does not believe that it is necessary for the Board to reconsider its prior decisions on the effective date and transition of the application guidance and disclosures.

Question – Effective date and transition

Does the Board agree with the staff's analysis in Paragraph 22 (ie that it is not necessary for the Board to reconsider its prior decisions on the effective date and transition of the application guidance and disclosures)?

If not, why not? What would the Board recommend instead?