Staff Paper

Contact(s)	Katherine Cancro	kcancro@ifrs.org	+44-207-246-6928

Project	**Offsetting Financial Assets and Liabilities**
Topic	**Consequential amendments and location of criteria within IFRSs**

Introduction

1. In March 2011, the IASB and the FASB published an exposure draft ('ED') to replace the offsetting requirements for financial instruments under US GAAP and IFRS and to improve the disclosure requirements relating to the rights of set-off and related arrangements.

2. At the June 2011 meeting the boards decided not to pursue a common offsetting model but rather to work on converging disclosure requirements related to offsetting to assist users comparing financial statements prepared under IFRS and US GAAP.

3. At the July meeting the boards tentatively decided to adopt revised disclosure requirements for rights of set-off and related arrangements.

4. Following the boards' preference for different offsetting approaches and hence the decision not pursue a common offsetting model (at the June 2011 joint meeting), at the 22 July IASB-only meeting the staff asked the IASB to reconfirm whether they would like to:

   a. move forward with the ED, as modified, or

   b. retain the current offsetting requirements in IAS 32 *Financial Instruments: Presentation.*

5. Eight members supported retaining the existing requirements, with seven supporting completing the ED. However, the Board also noted that during the

project, inconsistencies in the application of the offsetting requirements in IAS 32 were highlighted. The Board therefore asked the staff to prepare a paper that would consider whether those inconsistencies should be addressed and, if so, how. In the other Agenda Papers for this meeting, the staff recommends amendments to the application guidance to IAS 32 to address certain of these inconsistencies.

Purpose

6. This paper assesses whether the amendments to the application guidance to IAS 32 recommended by the staff in the other Agenda Papers for this meeting will require consequential amendments to other IFRSs, and if so, what amendments might be appropriate.
7. The following are existing standards that are somewhat linked to the offsetting guidance in IAS 32:
   a. IAS 12 *Income Taxes*
   b. IAS 19 *Employee Benefits*

Background

IAS 32 offsetting criteria

8. IAS 32 contains the following offsetting criteria for financial instruments:

> 42 A financial asset and a financial liability shall be offset and the net amount presented in the statement of financial position when, and only when, an entity:
>
> (a) currently has a legally enforceable right to set off the recognised amounts; and
>
> (b) intends either to settle on a net basis, or to realise the asset and settle the liability simultaneously.

IAS 12 – offsetting criteria

Current tax assets and liabilities

9. IAS 12 contains the following criteria for offsetting current tax assets and current tax liabilities:

> 71 An entity shall offset current tax assets and current tax liabilities if, and only if, the entity:
>
> (a) has a legally enforceable right to set off the recognised amounts; and
>
> (b) intends either to settle on a net basis, or to realise the asset and settle the liability simultaneously.
>
> 72 Although current tax assets and liabilities are separately recognised and measured they are offset in the statement of financial position subject to criteria similar to those established for financial instruments in IAS 32. An entity will normally have a legally enforceable right to set off a current tax asset against a current tax liability when they relate to income taxes levied by the same taxation authority and the taxation authority permits the entity to make or receive a single net payment.

Deferred tax assets and liabilities

10. In addition to those for current tax assets and liabilities, IAS 12 contains the following criteria for offsetting deferred tax assets and deferred tax liabilities:

> 74 An entity shall offset deferred tax assets and deferred tax liabilities if, and only if:
>
> (a) the entity has a legally enforceable right to set off current tax assets against current tax liabilities; and
>
> (b) the deferred tax assets and the deferred tax liabilities relate to income taxes levied by the same taxation authority on either:
>
> (i) the same taxable entity; or
>
> (ii) different taxable entities which intend either to settle current tax liabilities and assets on a net basis, or to realise the assets and settle the liabilities simultaneously, in each future period in which significant amounts of deferred tax liabilities or assets are expected to be settled or recovered.

IAS 12 – Staff analysis

11. IAS 32 paragraph 42(a) requires that an entity currently have a legally enforceable right of set-off in order to set off its financial assets and financial liabilities on the statement of financial position.

12. Some have interpreted this criterion that an entity currently has legally enforceable right of set-off if that right is exercisable only in the normal course of business, whereas others have interpreted it to mean a right that is legally enforceable both in the normal course of business and upon the default or bankruptcy of the counterparty.

13. In Agenda Paper 8A, the staff recommends that the Board add application guidance to IAS 32 to clarify that the meaning of an entity currently having a legally enforceable right is the latter—a right that is legally enforceable both in the normal course of business and upon the default or bankruptcy of the counterparty.

14. The staff notes that neither of the offsetting criteria in IAS 12 (current and deferred tax offset) contains the word ‘currently’ as in IAS 32. Paragraph 72 of IAS 12, however, states that the offsetting guidance in IAS 12 is similar to the offsetting criteria in IAS 32.

15. Because the offsetting criteria in IAS 12 do not include the term ‘currently’, the staff does not believe that the proposed changes to IAS 32 would affect the interpretation and application of IAS 12. Thus the staff does not believe any consequential amendments to IAS 12 or IAS 32 would be necessary, or that there are any issues that the Board ought to take into account in finalising the proposed replacement.

IAS 19 – offsetting criteria

16. IAS 19 contains the following criteria for offsetting assets and liabilities relating to different plans:

> 116 An entity shall offset an asset relating to one plan against a liability relating to another plan when, and only when, the entity:
>
> (a) has a legally enforceable right to use a surplus in one plan to settle obligations under the other plan; and
>
> (b) intends either to settle the obligations on a net basis, or to realise the surplus in one plan and settle its obligation under the other plan simultaneously.
>
> 117 The offsetting criteria are similar to those established for financial instruments in IAS 32 *Financial Instruments: Presentation*.

IAS 19 – Staff analysis

17. The staff notes that, similar to the IAS 12 criteria, the IAS 19 criteria do not contain the term 'currently'. Therefore, the staff does not believe the current interpretation and application of IAS 19 would, or should, change if amendments were made to the IAS 32 offsetting criteria for financial assets and financial liabilities.

18. Therefore, the staff recommends that IAS 19 should not be amended as a result of the proposed changes to IAS 32. Nor does the staff believe that any consequential amendments to IAS 32 would be necessary or there are any issues that the Board ought to take into account in finalising the proposed replacement.

Question for the Board
Does the Board agree with the staff recommendations in paragraphs 15 and 18 that no consequential amendments to other standards should be made as a result of the offsetting project? If not, what does the Board want to do and why?