December 2011

Project Summary and Feedback Statement

Disclosures—Offsetting Financial Assets and Financial Liabilities (Amendments to IFRS 7)

IFRS™

At a glance

In December 2011 the International Accounting Standards Board (IASB) and the US national standard-setter, the Financial Accounting Standards Board (FASB), jointly issued disclosure requirements about the effects of offsetting financial assets and financial liabilities and related arrangements on an entity's financial position.

The new disclosures will require entities to disclose gross amounts subject to rights of set-off, amounts set off in accordance with the accounting standards followed, and the related net credit exposure. This information will help investors understand the extent to which an entity has set off in its balance sheet and the effects of rights of set-off on the entity's rights and obligations.

The disclosures will provide greater comparability between financial statements prepared in accordance with International Financial Reporting Standards (IFRSs) and those prepared in accordance with US Generally Accepted Accounting Principles (GAAP).

The disclosures are effective for annual periods beginning on or after 1 January 2013. Retrospective application will be required to maximise comparability between periods.

Offsetting

Rights of set-off are a risk management tool that entities use to:

(a) reduce counterparty credit risk; and

(b) manage liquidity risk.

Enforceability of the rights varies by contract and jurisdiction.

In accounting, offsetting, or 'netting', is the presentation of the net amounts of financial assets and financial liabilities in the statement of financial position (balance sheet) as a result of an entity's rights of set-off.

Offsetting is important because, when applied, it reduces the amounts of assets and/or liabilities presented in the statement of financial position.

Background

The boards began this project in June 2010 with the objectives of improving the offsetting models in IFRSs and US GAAP, and achieving convergence.

The project responded to comments the boards had received as part of their wider financial instruments projects.

Auditors, investors, preparers, and the Financial Stability Board noted that the differences in offsetting models result in significant differences in amounts presented in balance sheets prepared in accordance with IFRSs and those prepared in accordance with US GAAP.

Investors highlighted that these differences, coupled with a lack of information about the amounts set off in the balance sheet, made it difficult to compare financial statements prepared in accordance with IFRSs and those prepared in accordance with US GAAP. This is particularly so for entities with large volumes of derivatives.

As a result of their efforts, in January 2011 the boards published a joint exposure draft proposing a common offsetting model that would have aligned offsetting in the balance sheet of IFRS and US GAAP preparers.

In response to feedback received on the proposals, in June 2011 the boards decided to retain their existing offsetting models and instead align their disclosure requirements to enable investors to better compare financial statements prepared in accordance with IFRSs and those prepared in accordance with US GAAP.

These disclosure requirements will also improve transparency in the reporting of how entities mitigate their credit risk.

The IASB also separately provided additional guidance on the application of its offsetting criteria in IAS 32 *Financial Instruments: Presentation* to address some divergence in practice that was highlighted during outreach on the exposure draft.

Existing offsetting models

Different offsetting models result in a significant quantitative difference between amounts presented in balance sheets prepared in accordance with IFRSs and amounts presented in balance sheets prepared in accordance with US GAAP. In addition, neither IFRSs nor US GAAP previously required disclosure of all amounts set off in the balance sheet.

An investor could therefore not compare the effects of rights of set-off between entities applying IFRSs and entities applying US GAAP.

This reduced the comparability of these entities' balance sheets, and was especially prominent in the presentation of derivative assets and derivative liabilities by financial institutions.

IFRSs

IFRSs generally require entities to present separately recognised financial assets and recognised financial liabilities at their gross amounts in the balance sheet, and therefore treat offsetting as an exception. An entity must set off its financial assets and financial liabilities in its balance sheet when it intends to set off and has the legally enforceable right to do so in the normal course of business, default and bankruptcy.

US GAAP

US GAAP provides a further exception for offsetting derivative instruments. This exception permits an entity to set off its derivative assets and derivative liabilities in the balance sheet if there is an agreement to set off, even if that right of set-off is only available in the case of bankruptcy or default. This means that balance sheets prepared in accordance with US GAAP generally present smaller amounts of these assets and liabilities than those prepared in accordance with IFRSs for an entity that has undertaken the same transactions.

What did the boards decide?

The boards agreed to issue common disclosure requirements to help investors compare financial statements prepared in accordance with IFRSs with those prepared in accordance with US GAAP.

Similar to the proposals in the exposure draft, the new disclosures require information about:

- the gross amounts of financial assets and financial liabilities before offsetting (a);
- the amounts set off in accordance with the related offsetting model (b);
- the net amounts presented in the balance sheet (c);
- the effect of financial instruments subject to master netting arrangements or similar agreements not already set off in the balance sheet, including related rights to collateral (d); and
- net amounts (e).

	Gross amounts before offsetting *[same for all preparers[1]]* (a)	**Gross amounts set off** *[depends on offsetting model]* (b)	**Net amounts presented in balance sheet** *[depends on offsetting model]* (c)	**Other amounts in scope but not set off in balance sheet** *[depends on offsetting model]* (d)	**Net amounts** *[same for all preparers[1]]* (e)
IFRSs	CU100	(CU10)	CU90	(CU30)	CU60
US GAAP	CU100	(CU40)	CU60	–	CU60

[1] This assumes the same transactions for both IFRSs and US GAAP.

The scope

The new disclosures are required for all recognised financial instruments that are set off in the balance sheet. The scope also includes financial instruments that are subject to enforceable master netting arrangements, global master repurchase agreements, global master securities lending agreements, and related rights to financial collateral.

Loans and customer deposits at the same institution and financial instruments that are subject only to a collateral agreement are not in the scope of the disclosures unless they are set off in the balance sheet.

While financial institutions will be among those most affected because of the types of instruments they typically have, the disclosures apply to all entities with financial instruments that fall within the scope of the requirements.

Both boards believe that the new disclosures will provide useful information about the entity's rights of set-off and the effects of these on the entity's credit exposure, irrespective of the nature of the entity's business.

Transition and effective date

The disclosures are effective for annual periods beginning on or after 1 January 2013.

Both boards are aware that the retrospective application of the disclosure requirements will cause additional work for preparers. However, there is no change in accounting requirements or accounting policies. In addition, both boards believe that retrospective application will maximise consistency of financial information between periods and thus enable the analysis and understanding of balance sheets between entities.

Amendments to IAS 32

In addition to the new disclosure requirements, the IASB also decided to separately provide additional application guidance for offsetting in accordance with IAS 32. This guidance is aimed at addressing current practice issues identified during outreach.

This guidance clarifies:

(a) the meaning of 'currently has a legally enforceable right of set-off'; and

(b) that some gross settlement systems may be considered equivalent to net settlement.

Due process and outreach activities

The Financial Stability Board and others had remarked on the differences in offsetting models between IFRSs and US GAAP and asked the boards to review their different requirements.

As part of their assessment, the boards invited representatives from banks, the International Swaps and Derivatives Association and experts in international financial law to participate in a joint education session for the boards in February 2010. The boards also discussed existing offsetting requirements with investors and other users of financial statements and asked the major accounting firms and various preparers for their views.

As a result of this work, and in response to comments received, the IASB and the FASB added an offsetting project to their joint agenda in June 2010.

Developing the proposals in exposure draft

As a result of the extensive outreach and education sessions and the limited scope of the project, in January 2011 the boards proceeded directly to the publication of the joint exposure draft *Offsetting Financial Assets and Financial Liabilities* instead of first publishing a discussion paper.

In addition, during the exposure draft consultation period the staff conducted further outreach activities including meetings, video and telephone conferences. The staff spoke to users of financial statements, preparers, auditors, regulators and clearing houses. The staff met with 61 investors and analysts representing 24 organisations in the US and with 130 users representing 50 organisations outside of the US.

The IASB staff also conducted an online survey to obtain additional views from investors on their preference for the presentation of financial assets and financial liabilities in the balance sheet: 36 users of financial statements from 6 regions and 9 sectors responded.

The comment period on the exposure draft ended in May 2011. The boards received 162 comment letters, which included responses from preparers, industry organisations, standard-setters, regulators, and various users of financial statements, from seven different regions. In May 2011, the boards also held joint round-table meetings with stakeholders in Asia, Europe and North America.

Finalising the proposals

Feedback across jurisdictions that apply IFRSs was generally supportive of the proposals in the exposure draft. However, feedback from US investors varied depending on their use of financial statements. If implemented, the proposed offsetting model would have substantially reduced offsetting for many US GAAP preparers.

Some stakeholders were also concerned about the additional burden as a result of the proposed disclosures, and that the cost of providing this information outweighed the benefits provided. They also questioned whether some of the more detailed information in the proposed disclosures met investors' needs.

As a result of the feedback received, in June 2011 the boards decided to retain their respective offsetting models, and instead to move forward with finalising the offsetting disclosure requirements, in consideration of address stakeholder concerns.

The revised disclosure requirements will provide investors with information that will assist them in comparing financial statements prepared in accordance with IFRSs with those prepared in accordance with US GAAP. The requirements will also provide information on both gross and net exposures as requested by investors.

The final disclosures are fundamentally aligned with the proposals in the exposure draft. They do not change offsetting requirements or accounting policies. They are, however, less burdensome than the disclosures originally proposed, while still providing investors with the information they need. For these reasons, both boards decided it was not necessary to re-expose the proposals.

Feedback statement

We received broad support for our efforts to develop a common offsetting model with the FASB.

Overall, respondents supported achieving convergence of the offsetting models and improving disclosures so that financial statements prepared in accordance with IFRSs and US GAAP would be more comparable.

While investors agreed that both gross and net information is useful, there was no consensus regarding when to provide net information in the balance sheet.

Preparers had mixed views about the proposed offsetting model.

Both boards considered the feedback received in the light of their current offsetting models and the information that investors need.

In the pages that follow we outline the more significant matters raised with us, how we responded and the final decisions made by both boards.

Offsetting criteria

The proposals in the exposure draft would have required an entity to set off when it had both the intent to set off and the ability to legally enforce its right to set off at all times. In all other circumstances offsetting was prohibited. The proposals, while broadly similar to current offsetting requirements in IFRSs, would have limited offsetting for US GAAP preparers, particularly for derivative instruments.

Respondents' comments

Preparers - In general, many IFRS preparers agreed with the criteria proposed in the exposure draft. The underlying principle and proposed criteria were similar to those in IAS 32, which have stood the test of time during the financial crisis. Many US GAAP preparers, while supporting the drive for a joint solution, believed that the US GAAP exception for derivatives provides a better reflection of an entity's solvency and exposure to credit and liquidity risks for those items.

Investors - Investors had different views as to what the criteria should be for presenting amounts on a net basis in the balance sheet. However, there was consensus that gross amounts (prior to netting) and net credit amounts are also needed to analyse financial statements.

Our response

As a consequence of feedback received, the IASB and the FASB each decided to maintain their existing offsetting models.

However, to meet the needs of investors and other users of financial statements, both boards decided to publish common disclosure requirements that will enable users of financial statements to compare information provided by both IFRS and US GAAP preparers and to evaluate the effect, or potential effect, of netting arrangements on an entity's financial position.

Disclosures

The objective of the disclosures is to enable users of financial statements to evaluate the effect, or potential effect, of netting arrangements on an entity's financial position.

The disclosures in the exposure draft would have applied to all recognised financial assets and recognised financial liabilities, subject to a right of set-off, and/or for which an entity had either received or pledged cash or other financial instruments as collateral.

The exposure draft also proposed detailed disclosures by class of financial instrument.

Respondents' comments

Preparers – Preparers believed that requiring disclosure of all rights of set-off is burdensome and overlaps with other required disclosures. In addition, preparers often view these rights as credit enhancements and not as the primary source of credit mitigation.

Preparers also believed that the cost of providing detailed disclosure by class of financial instrument would outweigh the benefits provided. They often manage credit exposure by counterparty and not by class of financial instrument. If they do manage by type of financial instrument they may not track all such rights of set-off in their financial reporting systems.

Investors – Although investors gave nearly unanimous support for the proposed disclosures in providing the information they need to perform their analyses, they indicated that they did not need information related to all rights of set-off to analyse offsetting requirements.

Investors also indicated that information by counterparty, by type or by class of financial instrument was useful, as long as they could reconcile these amounts back to, and compare, balance sheets.

Our response

Both boards agreed with the feedback received and as a result limited the scope of the disclosures to financial instruments set off in the balance sheet, and those subject to netting or similar arrangements. The boards excluded loans and customer deposits at the same institution from the scope (unless set off in the balance sheet). The boards also excluded financial instruments subject to collateral arrangements where there are no other rights of set-off.

The reduced scope addresses preparers' concerns while still providing the information that investors need.

Disclosures will be provided by type of financial instrument. Amounts subject to netting arrangements but not set off in the balance sheet (such as collateral and rights of set-off under master netting arrangements for IFRS preparers) will be presented by type of financial instrument or by counterparty.

The final revised disclosures provide gross and net credit amounts that will be the same for IFRS and US GAAP preparers. Investors will have the information they need to enable them to compare rights of financial statements as prepared in accordance with IFRSs with those set-off in accordance with US GAAP.

Effective dates

The exposure draft did not propose an effective date, but instead asked respondents for information about the time and effort that would be involved in implementing the proposed requirements.

Respondents' comments

Some respondents suggested that the offsetting proposals should have the same effective date as the IASB's project to replace IAS 39 *Financial Instruments: Recognition and Measurement* with IFRS 9 *Financial Instruments*.

If an earlier date was required it was suggested that application should be restricted only to the accounting period being presented, rather than providing comparative information, because of the potential burden of applying the new disclosure requirements.

Our response

At the time the amended disclosure requirements were issued (December 2011), IFRS 9 was not yet mandatorily effective.

The IASB did not believe that the IFRS 9 project would change the offsetting disclosures. Aligning the effective date of these amendments with the effective date of the wider financial instruments projects would mean a delay in providing investors the information that they need.

For investors to benefit from the increased comparability, and because the offsetting and IFRS 9 projects are independent of one another, the boards decided that common disclosures should be effective as early as possible.

Both boards concluded that a long transition period was not needed because the amended disclosures had a reduced scope and less detailed information than originally proposed in the exposure draft. The disclosures do not change accounting requirements or accounting policies but instead relate to the presentation of instruments that entities have already recognised and measured.

Both boards therefore decided that the mandatory effective date for the amended disclosures should be for annual periods beginning on or after 1 January 2013.

Effect analysis

During their outreach and redeliberations, both boards considered the potential costs and benefits arising from the proposed disclosure requirements.

Costs for preparers

Additional costs for preparers may arise as a result of determining the instruments that would fall within the scope of the disclosures if they do not already set off in accordance with IFRSs or US GAAP.

Additional costs incurred may also arise from making the disclosures operational, because the risk related to these of instruments may be tracked and managed via an entity's risk management system instead of its financial reporting system, especially if the entity does not set off on its balance sheet.

As a result of the feedback received, and in consideration of the costs of providing the disclosures, the IASB and the FASB decided to limit the scope of the disclosures.

The new disclosure requirements are not a change to the offsetting requirements or a change in accounting policy. Instead, combined with the reduced scope, the requirements reduce the cost to preparers while still providing the information that investors need.

Benefits to investors

These disclosure requirements will provide transparency about significant differences that arise between the net amounts presented in accordance with IFRSs and those presented in accordance with US GAAP, particularly for entities that have large amounts of derivative activities, and will result in increased comparability between the amounts presented in accordance with both sets of standards. The requirements will also give investors the information they need to understand the amounts that have been set off in an entity's balance sheet.

The requirements will provide investors and other users of financial statements with better information to assess an entity's credit and cash flow risks that result from the entity's rights of set-off and related arrangements.

Important information

This Project Summary and Feedback Statement has been compiled by the staff of the IFRS Foundation for the convenience of interested parties. The views expressed within this document are those of the staff who prepared the document. They do not purport to represent the views of the IASB and should not be considered as authoritative.

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