Australian Accounting Standard **AAS 23**

December 1996

Set-off and Extinguishment of Debt

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Defined words appear in *italics* the first time they appear in a section. The definitions are in Section 11. Standards are printed in **bold** type and commentary in light type.

MAIN FEATURES OF THE STANDARD

The Standard:

(a) requires debt to be accounted for as extinguished when settled through repayment or replacement by another liability

(b) prescribes the conditions to be met before a debt can be accounted for as having been extinguished in the following circumstances:

  (i) legal defeasance

  (ii) in-substance defeasance via a trust

  (iii) in-substance defeasance via assumption by a risk-free entity

(c) prescribes the accounting required when the conditions for extinguishment cease to be met

(d) prescribes the accounting for partial extinguishments

(e) explains the application of the defeasance conditions in the context of consolidated financial reports

(f) prescribes the accounting for costs of defeasance and gains and losses on defeasance

(g) prescribes specific disclosures concerning defeasances and defeased debt

(h) requires assets and liabilities to be set off in the presentation of the statement of financial position when:

  (i) there is a legal right of set-off; and

  (ii) the entity intends to settle the asset and the liability on a net basis or simultaneously.

AUSTRALIAN ACCOUNTING STANDARD

AAS 23 "SET-OFF AND EXTINGUISHMENT OF DEBT"

1 Application

1.1 This Standard applies to *general purpose financial reports* of each *reporting entity* to which Accounting Standards operative under the Corporations Law do not apply.

1.2 This Standard applies to financial reports that are held out to be general purpose financial reports by an *entity* which is not a reporting entity, and to which Accounting Standards operative under the Corporations Law do not apply.

1.2.1 Accounting Standards operative under the Corporations Law apply to companies and to other entities required by legislation, ministerial directive or other government authority to apply such Standards. Reporting entities which are not required to apply Accounting Standards operative under the Corporations Law are required to apply this Standard.

1.2.2 The standards specified in this Standard apply to the financial report where information resulting from their application is material, in accordance with Australian Accounting Standard AAS 5 "Materiality".

2 Operative Date

2.1 This Standard applies to reporting periods ending on or after 31 December 1997.

2.2 This Standard may be applied to reporting periods ending before 31 December 1997.

2.2.1 AAS 23 "Set-off and Extinguishment of Debt", as issued in June 1990, continues to apply for reporting periods that end before 31 December 1997. However, where an *entity* elects to apply this Standard early in accordance with paragraph 2.2 it will not also be obliged to comply with AAS 23, as issued in June 1990, for the reporting periods to which the election applies.

2.3 When operative, this Standard supersedes Australian Accounting Standard AAS 23 as issued in June 1990.

3 Purpose of Standard

3.1 The purpose of this Standard is to:

(a) specify when a debt is to be accounted for as having been extinguished, including by way of *defeasance*

(b) prescribe the method of accounting for the extinguishment of debt, including by way of defeasance

(c) establish criteria for the *set-off* of *assets* and *liabilities* in the presentation of the statement of financial position which do not overrule specific requirements of other Australian Accounting Standards

(d) require disclosure in the financial report of information relating to the defeasance of debt.

3.1.1 This Standard does not establish criteria for determining whether transactions or events should be accounted for as separate assets and liabilities. In relation to the set-off provisions, it is concerned only with preventing the omission of assets and liabilities from the face of the statement of financial position by means of set-off where no *right of set-off* exists. The Standard does not therefore establish whether transactions such as cross-currency and interest-rate swaps, foreign currency forward exchange agreements and leveraged leases give rise to separate assets and liabilities.

4 Extinguishment of Debt

4.1 A debt must be accounted for as having been extinguished when, and only when, it has been:

(a) settled through repayment or replacement by another *liability*; or

(b) subject to a *legal defeasance* which meets the conditions set out in paragraph 4.2; or

(c) **subject to an *in-substance defeasance* employing a trust which meets the conditions set out in paragraphs 4.2 and 4.3; or**

(d) **subject to an in-substance defeasance in which a *risk-free entity* assumes responsibility for the servicing requirements (both interest and principal) of the debt in a manner which meets the conditions set out in paragraph 4.2.**

4.2 For a debt to be accounted for as having been extinguished through a legal defeasance or an in-substance defeasance, it is a condition that it is highly improbable that the *entity* will be required to assume again the primary obligation for the debt servicing requirements (interest or principal) or to satisfy any guarantee, indemnity or the like relating to such requirements.

4.3 The conditions to be met before a debt is accounted for as having been extinguished through an in-substance defeasance employing a trust include:

(a) ***risk-free assets* are irrevocably transferred to a trust, the trustees of which are independent, and remain independent, of the entity, and which trust is used solely for administering those *assets* so as to meet the servicing requirements (both interest and principal) of the debt; and**

(b) **the assets transferred to the trust are of an amount and type suited to the amount and timing of the servicing requirements (both interest and principal) of the debt.**

Extinguishment

4.3.1 Implicit in the definition of a liability specified in paragraph 11.1 is that a debt ought to be removed from the statement of financial position when it has been extinguished. The liability of a debtor for a debt may be extinguished in a number of ways:

(a) by settlement through repayment or replacement by another debt; or

(b) through legal defeasance, including forgiveness, assumption by a third party or legal judgement; or

(c) through an in-substance defeasance.

Defeasance

4.3.2 As defined in paragraph 11.1, *defeasance* means the release of a debtor from the primary obligation for a debt. A legal defeasance could take place in absolute terms, that is, the debt could cease to exist for anyone (by being forgiven or set aside), or the creditor could formally recognise that another party has taken over the primary obligation for the debt.

In-Substance Defeasance

4.3.3 The release of a debtor from the primary obligation for a debt may also be achieved "in substance" by the debtor, either by transferring to a trust assets which are adequate to meet the servicing requirements (both interest and principal) of the debt and are dedicated to that purpose, or by having a suitable entity assume responsibility for those servicing requirements. Under this Standard, in-substance defeasance is subject to strict conditions before the liability involved can be considered extinguished for accounting purposes and removed from the statement of financial position.

4.3.4 The conditions required by this Standard to be met before a debt can be considered extinguished for accounting purposes through an in-substance defeasance which employs a trust include the irrevocable transfer of risk-free assets to a trust. Risk-free assets are, as defined in paragraph 11.1, limited to cash, or securities of a creditworthy government or of a body guaranteed under statute by a creditworthy government, which are denominated in the same currency as the debt being defeased. The reference to cash in the definition of risk-free assets includes currency and cash at bank. It does not include any form of term investment account with a bank, unless that account qualifies specifically as a government-guaranteed security. It also does not include variable-rate securities unless the variable rate matches the rate on the debt being defeased. It is expected that cash would be held by a trust that qualifies under this Standard only for the purposes of acquiring government-guaranteed securities, for meeting debt servicing requirements or for meeting the costs of administering the trust. The strictness of the definition of risk-free assets is required if a debtor is to be left virtually in the same position, in terms of risk, after an in-substance defeasance as would apply if the debt had in fact been settled or legally defeased.

Instantaneous In-Substance Defeasance

4.3.5 It is sometimes argued that there should be a prohibition on the removal of debt from the statement of financial position where that debt is expressly incurred for the purpose of immediate or near immediate investment in higher yielding securities to be held by a trust in the manner set out above for an in-substance defeasance; that is, that accounting for an in-substance defeasance as an extinguishment when that defeasance is "instantaneous" should be prohibited. It is argued that, in these circumstances, the principal purpose of the transaction is to borrow and invest to achieve benefits from interest rate differentials, rather than to extinguish existing debt. There is usually no opposition to a legal "instantaneous" defeasance being accounted for as an extinguishment.

4.3.6 This Standard requires the removal of debt from the statement of financial position of the debtor when the primary obligation of the debtor has been discharged or the debtor has been placed in virtually the same position as if the debt had been discharged. Although it is possible to distinguish the circumstances of a normal in-substance defeasance from those of an instantaneous in-substance defeasance, it may not be possible to distinguish the position of the debtor in terms of subsequent lack of primary obligation. Accordingly, this Standard requires accounting for an instantaneous in-substance defeasance as an extinguishment, provided that the conditions referred to in paragraph 4.1 for an in-substance defeasance are met.

Consolidation Adjustments

4.3.7 The accounting by a subsidiary for the extinguishment of a debt through a defeasance needs to be reversed for the consolidated financial report if the defeasance conditions are not met in relation to another entity in the *economic entity*. For example, for an in-substance defeasance which employs a trust, the trustees may be independent of the subsidiary but not independent of the *parent entity* or of another entity within the economic entity. Thus, for a debt to be accounted for in consolidated financial reports as extinguished through defeasance, the conditions referred to in paragraph 4.1 need to be met in the context of the economic entity.

Treatment of Defeasance when Conditions No Longer Met

4.4 **If any of the conditions for extinguishment referred to in paragraph 4.1 cease to be met in respect of a debt accounted for as having been extinguished through a defeasance, then the**

remaining original debt and, for an in-substance defeasance employing a trust, the related assets remaining in the trust must be reinstated in the financial report of the entity.

4.4.1 Before the liability to the creditor is settled, any of the conditions for extinguishment may cease to be met in respect of a debt accounted for as having been extinguished through an in-substance defeasance. For example, assets held in trust may cease to meet the definition of risk-free assets. In reinstating the remaining original debt, the amount of the liability is calculated by discounting the amounts still to be paid at the interest rate implicit in the original debt.

Partial Extinguishment

4.5 An amount of debt must be accounted for as having been extinguished by defeasance only if both the principal and the interest related thereto are accounted for as having been extinguished. The outstanding liability for a debt which has been subject to partial extinguishment must be determined by discounting any remaining debt servicing requirements (interest or principal) at the rate of interest implicit in the arrangement giving rise to the original debt.

4.6 Where the amount to be defeased is equal to the contractual principal of a debt (or part thereof), or is equal to an amount stipulated as interest on a debt, the defeasance must be accounted for as a partial extinguishment in accordance with paragraph 4.5.

4.6.1 There is nothing to preclude accounting for a partial extinguishment of debt by defeasance in the same manner as for a complete extinguishment by defeasance. That is, the same accounting applies for situations in which a proportion of debt servicing requirements (both interest and principal) is defeased as for when all such requirements are defeased. This Standard does not permit, for the reasons set out in paragraphs 4.6.2 and 4.6.3, debt to be accounted for as if either the principal or interest of a debt, in accounting terms, had been separately defeased (in whole or in part).

4.6.2 An "in-substance defeasance" can be arranged so that an amount equal to the legal principal of a debt is defeased. However, under this type of arrangement, the debtor is still to make payments of amounts equal to the interest payments which would have been due on the debt. In this situation, the debtor still has a liability. The

amount of the liability is calculated by discounting the amounts still to be paid at the interest rate implicit in the "original" debt. The substance of this type of arrangement is that only part of the original

principal, together with the interest relating thereto, has been defeased, despite the "legal form" of the arrangement which may suggest that the principal has been defeased. If an amount of debt is indeed defeased, the debtor should face no further debt servicing requirements, whether interest or principal, in respect of that amount of debt.

4.6.3 When the stipulated interest relating to a debt has been defeased, and not the legal principal, there must still be an interest component in the amounts to be paid in the future. Again, the amount of the remaining liability is determined by discounting the future payments at the interest rate implicit in the "original" debt. In effect, only a proportion of the interest and principal will have been defeased, despite the "legal form" of the arrangement.

4.6.4 It follows from paragraphs 4.6.2 and 4.6.3 that, in a partial extinguishment, it is necessary to account for both a part of the principal and the interest related thereto as having been defeased.

5 Costs of Defeasance

5.1 Any fee payable in respect of arranging a *defeasance* of debt must be *recognised* as an *expense* as at the date of entering into the defeasance arrangement.

5.2 Where there are on-going costs to be incurred in administering a trust employed for an *in-substance defeasance*, those costs must either be adequately allowed for in the determination of the amount of *assets* to be transferred to the trust or the debtor must recognise as at the date of the defeasance a *liability* and an expense for those costs.

6 Gains and Losses on Defeasance of Debt

6.1 The carrying amounts of *assets* and *liabilities* to be accounted for under a *defeasance* arrangement must be determined by discounting their future cash flows at the rates of interest implicit in the arrangements giving rise to those assets and liabilities.

6.2 Any adjustment to the carrying amounts of assets and liabilities required by paragraph 6.1 must be *recognised* as a *revenue* or an *expense* as at the date of entering into the defeasance arrangement.

6.3 When the carrying amount of an asset given up in defeasance of a debt differs from the carrying amount of the debt, the difference must be recognised as a revenue or an expense as at the date of entering into the defeasance arrangement.

6.3.1 When the carrying amount of an asset given up in extinguishment of a liability is different from the carrying amount of that liability, the difference represents a gain or loss on extinguishment. The occurrence of such a gain or loss could be due to the availability of opportunity gains (including interest rate differentials) or hardships facing either the debtor or creditor.

6.3.2 It is a common feature of *in-substance defeasances* that the assets placed in trust, or transferred to an *entity* which assumes the primary obligation for the debt servicing requirements, will achieve a higher rate of return than the rate of interest payable on the debt being defeased. In such a situation, the carrying amount of the assets given up can be less than the carrying amount of the debt defeased. As both the assets and liability involved have been, respectively, given up and extinguished from the debtor's viewpoint, a gain has been made on defeasance of the debt.

6.3.3 In some defeasance arrangements, including *legal defeasance*, the debtor may forego the stipulated interest receivable on a long-term receivable as part of the arrangement. It is necessary in these cases to recognise as an expense a discount in relation to the receivable, determined by discounting the sum receivable in the future (at the rate implicit in the arrangement giving rise to the receivable) to its principal equivalent at the date of defeasance. The decrease in the carrying amount of the receivable, together with the carrying amount of any other asset given up, is compared with the carrying amount of the debt in determining the gain or loss on defeasance.

7 Disclosures

7.1 The following information must be disclosed:

(a) in a reporting period in which *defeasance* takes place:

(i) the aggregate carrying amount of *assets* given up for the purpose of defeasance

(ii) the aggregate carrying amount of debt extinguished by defeasance

(iii) **the net gain or loss on defeasance, calculated as the aggregate of any *revenues* or *expenses recognised* in accordance with paragraphs 5.1, 5.2, 6.2 and 6.3**

(b) **in respect of any defeased debt, details of any amounts defeased which are outstanding, and of any outstanding guarantees, indemnities or the like given by or on behalf of the debtor.**

8 Comparative Information

8.1 Subject to paragraph 8.2, information for the preceding corresponding reporting period which corresponds to the disclosures specified for the current reporting period must be disclosed.

8.2 If the disclosure requirements in paragraph 7.1 have not previously applied to the *entity*, the information required by paragraph 8.1 need not be disclosed.

9 Set-off of Assets and Liabilities

9.1 An *asset* and a *liability* must be *set off* and the net amount *recognised* in the statement of financial position when, and only when, the *entity*:

(a) **has a legally recognised right to set off the asset and the liability; and**

(b) **intends either to settle on a net basis, or to realise the asset and settle the liability simultaneously.**

9.1.1 Generally, the amounts of assets and liabilities are not set off when presenting a statement of financial position. However, this Standard requires the presentation of assets and liabilities on a net basis when this reflects the entity's *right of set-off* and the expected future cash flows from settling assets and liabilities. When an entity has the right to receive or pay a single net amount and intends to do so, it has, in effect, only a single asset or liability. In other circumstances, assets and liabilities are normally presented separately from each other, consistent with their characteristics as resources or obligations of the entity. Not to show those assets and liabilities separately

limits the ability of users of the financial report to assess the future benefits available to, and obligations facing, the entity.

9.1.2 In some situations it can be difficult to determine whether in substance an entity has only a single asset or liability, or both an asset and a liability. If it has only a single asset or liability, the set-off conditions do not have any effect on the presentation of that item, except in assessing whether set-off with other assets or liabilities is required. Furthermore, Australian Accounting Standard AAS 33 "Presentation and Disclosure of Financial Instruments" notes that a single (net) asset or liability may be recognised for individual derivative financial instruments that embody both a financial asset and a financial liability.

9.1.3 Setting off a recognised asset and a recognised liability and presenting the net amount differs from ceasing to recognise an asset or a liability. While setting off does not give rise to recognition of a gain or loss, ceasing to recognise an asset or a liability not only results in the removal of the previously recognised item from the statement of financial position but may also result in recognition of a gain or a loss.

9.1.4 A right of set-off is a debtor's legally recognised 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. Thus, a right of set-off may exist where one entity in an *economic entity* owes an amount to another entity (not part of the economic entity) whilst a different entity in the economic entity is owed an amount by that other entity. Each entity involved in a right of set-off may be an economic entity.

9.1.5 In unusual circumstances, a debtor may have a right to apply an amount due from a third party against the amount due to a creditor provided that there is an agreement among the three parties that clearly establishes the debtor's right of set-off. Since a legally recognised right of set-off comprises rights of set-off that are recognised at law or in proceedings in equity, the conditions supporting the right may vary from one jurisdiction to another and care must be taken to establish which laws apply to the relationships between the parties.

9.1.6 The existence of a right to set off an asset and a liability affects the rights and obligations associated with an asset and a liability and may affect significantly an entity's exposure to credit and liquidity risk. However, the existence of the right, by itself, is not a sufficient basis for setting off. In the absence of an intention to

exercise the right or to settle simultaneously, the amount and timing of an entity's

future cash flows are not affected. When an entity does intend to exercise the right or to settle simultaneously, 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. An intention by one or both parties to settle on a net basis without a legally recognised right to do so is not sufficient to justify setting off since the rights and obligations associated with the individual asset and liability remain unaltered.

9.1.7 Simultaneous settlement 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 receive and pay 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. Realisation and settlement of an asset and a liability at the same nominal time but in different time zones does not amount to simultaneous settlement.

9.1.8 The conditions set out in paragraph 9.1 are generally not satisfied and setting off is usually inappropriate when:

(a) several different assets and liabilities are used to emulate the features of a single asset or liability (that is, a "synthetic arrangement"); or

(b) assets and liabilities have the same primary risk exposure (for example, assets and liabilities within a portfolio of forward contracts or other derivative instruments) but involve different counterparties; or

(c) assets are pledged as collateral for non-recourse liabilities; or

(d) obligations incurred as a result of events giving rise to losses are expected to be recovered from a third party by virtue of a claim made under an insurance policy.

9.1.9 The principle expressed in paragraph 9.1 applies irrespective of the type of collateral which exists for a debt. The collateral for a debt is

irrelevant to the question of whether assets and liabilities should be shown separately (or included in separate totals) in the statement of

financial position. Further, the ultimate risk that an entity faces in relation to meeting a liability may be negligible or non-existent because of the collateral for the debt, but this is an insufficient reason of itself not to reveal to users of the financial report the asset and liability in question. This is because those users will be concerned with aspects of an entity's performance and financial position in areas other than just risk.

9.1.10 Assets and liabilities set off by a subsidiary pursuant to a right of set-off do not need to be reinstated in consolidated financial reports. The right of set-off remains effective, and the agreement in relation to the setting off of assets and liabilities does not need to acknowledge a right of set-off in the context of the economic entity.

10 Transitional Provisions

10.1 Where the superseded Standard did not apply to the *entity* and accounting policies required by this Standard are not already being applied as at the beginning of the reporting period to which this Standard is first applied, they must be applied as at that date. Where this gives rise to initial adjustments, the net amount of those adjustments must, in accordance with Australian Accounting Standard AAS 1 "Profit and Loss or other Operating Statements", be adjusted against retained profits (surplus) or accumulated losses (deficiency) as at the beginning of the reporting period to which this Standard is first applied.

11 Definitions

11.1 In this Standard:

***assets* means future economic benefits controlled by the *entity* as a result of past transactions or other past events**

***defeasance* means the release of a debtor from the primary obligation for a debt**

economic entity* means a group of entities comprising the *parent entity* and each of its *subsidiaries

***entity* means any legal, administrative, or fiduciary arrangement, organisational structure or other party**

(including a person) having the capacity to deploy scarce resources in order to achieve objectives

equity **means the residual interest in the** ***assets*** **of the entity after deduction of its** ***liabilities***

expenses **means consumptions or losses of future economic benefits in the form of reductions in assets or increases in liabilities of the entity, other than those relating to distributions to owners, that result in a decrease in** ***equity*** **during the reporting period**

general purpose financial report **means a financial report intended to meet the information needs common to users who are unable to command the preparation of reports tailored so as to satisfy, specifically, all of their information needs**

in-substance defeasance **means a** ***defeasance*** **other than a** ***legal defeasance*** **in which the debtor effectively achieves release from the primary obligation for a debt either by placing in trust assets which are adequate to meet the servicing requirements (both interest and principal) of the debt or by having a suitable entity assume responsibility for those servicing requirements**

legal defeasance **means a defeasance in which the release of the debtor from the primary obligation is either acknowledged formally by the creditor or by a duly appointed trustee of the creditor, or established by legal judgement**

liabilities **means future sacrifices of economic benefits that the entity is presently obliged to make to other entities as a result of past transactions or other past events**

parent entity **means an entity which controls another entity**

recognised **means reported on, or incorporated in amounts reported on, the face of the profit and loss or other operating statement or of the statement of financial position (whether or not further disclosure of the item is made in notes)**

reporting entity **means an entity (including an** ***economic entity*****) in respect of which it is reasonable to expect the existence of users dependent on** ***general purpose financial reports*** **for**

information which will be useful to them for making and evaluating decisions about the allocation of scarce resources

revenues **means inflows or other enhancements, or savings in outflows, of future economic benefits in the form of increases in assets or reductions in liabilities of the entity, other than those relating to contributions by owners, that result in an increase in equity during the reporting period**

right of set-off **means that right which:**

(a) allows the entity to offset the amount owed to one entity against the amount owed by that or another entity; and

(b) is recognised at law or in equity

risk-free assets **means cash, or securities of a** ***risk-free entity*****, which are denominated in the same currency as the debt being defeased**

risk-free entity **means a creditworthy government or a body guaranteed under statute by a creditworthy government**

set-off **means the reduction of an asset by a liability or of a liability by an asset in the presentation of the statement of financial position so that the net amount only is** ***recognised***

subsidiary **means an entity which is controlled by a parent entity.**

11.1.1 Guidance as to the definitions of assets, liabilities, equity, *revenues* and *expenses* is contained in Statement of Accounting Concepts SAC 4 "Definition and Recognition of the Elements of Financial Statements".

CONFORMITY WITH INTERNATIONAL AND NEW ZEALAND ACCOUNTING STANDARDS

Conformity with International Accounting Standards

As at the date of issue of this Standard, compliance with this Standard will ensure conformity with the set-off criteria set out in International Accounting Standard IAS 32 "Financial Instruments: Disclosure and Presentation", with the following exception. IAS 32 does not allow set-off when financial assets are set aside in a trust by a debtor for the purpose of discharging an obligation if the assets have not been accepted by the creditor in settlement of the obligation. This Standard treats in-substance defeasances as extinguishing the liability when the prescribed conditions are satisfied. Accounting for in-substance defeasances was not addressed in the exposure draft preceding this Standard. The Board expects to issue an exposure draft during its harmonisation program to address the matter.

Conformity with New Zealand Accounting Standards

As at the date of issue of this Standard, compliance with this Standard will ensure conformity with Financial Reporting Standards FRS-26 "Accounting for Defeasance of Debt" and FRS-27 "Right of Set-off", with the following exceptions. These aspects will be considered when the Board undertakes a full review of the Standard.

(a) debt servicing requirements under FRS-26 include foreign exchange exposures and contractual fees

(b) FRS-26 requires the higher threshold of virtual certainty that the entity will not be required to assume again the primary obligation for the debt servicing requirements or to satisfy any guarantee or the like in relation to defeased debt

(c) FRS-26 specifies that cash can only be included as risk-free assets when it is held with a creditworthy bank unrelated to the debtor

(d) risk-free assets under this Standard include securities of a body guaranteed under statute by a creditworthy government whereas FRS-26 includes securities guaranteed by a creditworthy government

(e) FRS-26 requires the recognition of gains or losses on the reinstatement of assets and liabilities and specifies particular disclosure requirements for reinstatements

(f) disclosure of maturity dates for amounts outstanding under in-substance defeasances is also required by FRS-26

(g) FRS-27 permits the set-off of only monetary assets and monetary liabilities and requires the parties to acknowledge the right of set-off of each party

(h) FRS-27 does not allow set-off when simultaneous settlement is expected

(i) revenues and expenses are required by FRS-27 to be set off when the related assets and liabilities have been set off

(j) FRS-27 specifies disclosures concerning assets and liabilities that meet the set-off criteria but have not been set off, assets and liabilities subject to a right of set-off in the future, and outstanding risks of assets and liabilities that have been set off.

BACKGROUND TO REVISION

This section does not form part of the Standard. It is a summary of the reasons for the current revision to the Standard.

1 The issue of the Standard follows consideration of the responses received on Exposure Draft ED 65 "Presentation and Disclosure of Financial Instruments (and Revision of Set-off Criteria in AAS 23 and AASB 1014)", which was prepared by the Public Sector Accounting Standards Board of the Australian Accounting Research Foundation and by the Australian Accounting Standards Board and released in June 1995. In addition, before finalising the Standard the Boards considered responses to a summary of the principal issues and comments in the submissions on ED 65, which included the Boards' tentative decisions on the issues. The summary was provided to all respondents to ED 65.

2 The Boards developed ED 65 using as a basis International Accounting Standard IAS 32 "Financial Instruments: Disclosure and Presentation", which was issued by the International Accounting Standards Committee in June 1995. The set-off criteria in this Standard are the same as in IAS 32. Accordingly, the circumstances in which set-off is appropriate have been extended to situations involving more than two entities and to situations when simultaneous settlement is intended (rather than net settlement).

3 Some respondents to ED 65 requested that the set-off criteria be extended further, for example by allowing set-off when an entity has the ability to settle net rather than an intention to settle net or simultaneously. The Boards retained the set-off criteria as proposed principally because the statement of financial position is intended to present assets and liabilities, and not merely a summary based on net risks. Set-off under agreements that allow net settlement of amounts outstanding between two (or more) parties in circumstances of default is therefore appropriate only when default has occurred.

4 The meaning of "simultaneous settlement" as settlement at the same moment was retained as proposed in ED 65, because the cash flows are effectively equivalent to a single net amount. This approach is the same as in IAS 32. Furthermore, when a single asset or liability is recognised under a financial instrument, the set-off criteria are relevant only in assessing whether set-off with other assets or liabilities is required. Australian Accounting Standard AAS 33 "Presentation and Disclosure of Financial Instruments" addresses the assets and liabilities that arise under various types of financial

instruments. For example, prior to maturity forward contracts and similar derivative financial instruments are regarded as giving rise to both an asset and a liability, however the asset and the liability may be recognised on a net basis.

5 This Standard has been presented in the Boards' current style, for example the definitions are placed at the end of the Standard. The sequence of the extinguishment of debt provisions has been restructured in this Standard to place standards and commentary paragraphs in proximity, and the text has been simplified. However, there are no changes of substance from the extinguishment requirements in the superseded Standard. Comparative information requirements and transitional provisions have been added.