



To:	AASB members	Date:	11 October 2011
From:	Christina Ng	Agenda Item:	10.1
Subject:	Offsetting Financial Assets and Financial Liabilities – project update	File:	

Action

Receive an update on the tentative decisions made by the IASB on the project Offsetting Financial Assets and Financial Liabilities, and consider if there are any issues that need to be raised with the IASB on those tentative decisions.

Staff recommendation

Staff do not consider there are any issues identified in the Appendix of this memo that need to be raised formally with the IASB in relation to the tentative decisions made to date.

Question to the Board

Does the Board agree with the staff recommendation?

Background

IASB ED/2011/1 *Offsetting Financial Assets and Financial Liabilities*, published in January 2011, was a consequence of joint decisions made by the IASB and the FASB to address differences between the offsetting requirements of IAS 32 *Financial Instruments: Presentation* and US GAAP.

ED/2011/1 dealt with principles for offsetting financial assets and financial liabilities, additional guidance and additional disclosures about financial assets and financial liabilities that would qualify for offsetting. The IASB did not propose changing the existing offsetting requirements in IAS 32, however, ED/2011/1 introduced new application guidance intended to clarify the principles for offsetting.

The AASB was supportive of the IASB's proposal in ED/2011/1 to retain the IAS 32 offsetting requirements but had concerns with the proposed application guidance.

In June 2011, in light of feedback received on ED/2011/1, the IASB and FASB decided to progress the project with separate offsetting models while they work on converging disclosure requirements to assist users in comparing financial statements prepared in accordance with IFRSs and US GAAP.

The IASB tentatively decided not to proceed with the application guidance proposed in ED/2011/1, and instead, retain the existing requirements and guidance in IAS 32. In addition, the IASB tentatively decided to refine only those existing terms in IAS 32 identified during the Offsetting project that have resulted in divergent views and practice. These matters are discussed in the Appendix.

The IASB expects to publish the amendments to IAS 32 to introduce the additional guidance by December 2011.

Next steps

At the time of preparing this memo, the IASB plans to discuss at the 19-21 October 2011 meeting sweep issues relating to the amendments to IAS 32. Staff will provide a verbal update on any significant matters.

Tentative decisions made by the IASB on the Offsetting Financial Assets and Financial Liabilities project

The offsetting requirements in paragraph 42 of IAS 32 are:

“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.”

An overview of tentative decisions made by the IASB in view of clarifying the existing requirements in IAS 32 is summarised in the table below.

Key issues with existing IAS 32	Overview of IASB tentative decisions
<p>The term ‘currently’ in paragraph 42(a) of IAS 32</p>	<p>IAS 32 does not provide any guidance to the meaning of ‘currently has a legally enforceable right of set-off’.</p> <p>It is common for the term ‘currently’ to be interpreted as a right exercisable only in the normal course of business, and not as a right enforceable in all circumstances including the normal course of business, default, bankruptcy and insolvency, which was the intention of the IASB in writing IAS 32.</p> <p>The IASB tentatively decided to include application guidance to confirm that a right of set-off should be legally enforceable both in the normal course of business and in the event of default, bankruptcy and insolvency of one of the counterparties.</p> <p>Based on the AASB’s comments and our constituents’ feedback on ED/2011/1, AASB staff do not consider there are any issues to raise with the IASB.</p>
<p>The term ‘simultaneous settlement’ in paragraph 42(b) of IAS 32</p>	<p>IAS 32 includes a requirement for simultaneous settlement and defines simultaneous as occurring ‘at the same moment’ [paragraph 48]. This definition was also included in ED/2011/1, and many respondents argued that the ‘at the same moment’ requirement is inconsistent with settlement practices today.</p> <p>The IASB tentatively decided to clarify the definition of ‘net settlement’ in the application guidance of IAS 32 to include gross settlement mechanisms with features that eliminate or result in insignificant credit and liquidity risk and under which processing of receivables and payable occur in a single settlement process. The likely distinguishing factors to be included in IAS 32 include:</p> <ul style="list-style-type: none"> (a) financial assets and financial liabilities that meet the right of offset criterion are submitted for processing at exactly the same point (i.e. same settlement date); (b) once submitted for processing, the transactions cannot be cancelled or altered; (c) there is no potential for the cash flows arising from the assets and liabilities to change once they have been submitted for processing unless the processing fails; (d) if the processing of one asset or liability that is offset against another fails, then the processing of the related security used as collateral also fails; (e) processing is carried out through the same settlement depository; and (f) there is a high likelihood that an intra-day credit facility is available and would be honoured until the settlement process is complete. <p>Based on the AASB’s comments and our constituents’ feedback on ED/2011/1, AASB staff do not consider there are any significant issues to raise with the IASB.</p>