Straight away
An overview of financial reporting developments

IASB and FASB address differences in balance sheet offsetting requirements between IFRS and US GAAP

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What's the issue?

The IASB and FASB have issued proposals to address differences in the balance sheet offsetting requirements between IFRS and US GAAP. It is the single largest quantitative balance sheet difference between the two accounting frameworks today. The exposure draft will result in a converged standard for offsetting financial assets and financial liabilities on the balance sheet.

Key Provisions

The proposals require an entity to offset a recognised financial asset and financial liability only if it has an unconditional right of set-off and intends either to settle the asset and liability on a net basis or to realise the asset and settle the liability simultaneously.

An unconditional right of set-off is one where the right is not contingent on a future event. In other words, the right exists in the normal course of business and is enforceable in all circumstances (that is, not only in the event of default or bankruptcy).

Realisation of a financial asset and settlement of a financial liability is treated as simultaneous only when the transactions are made at the same moment, and there is no exposure to credit or liquidity risk for the gross amounts.

Master netting agreements where the legal right of offset is only enforceable on the occurrence of some future event, such as default of the counterparty, do not meet the offsetting requirements.

Disclosures

The proposals will require more extensive disclosures than are currently required under IFRS and US GAAP. The disclosures focus on quantitative information about rights of set-off, including conditional rights of set-off, and related collateral arrangements.

Transition and effective date

The Boards are proposing that the requirements be applied retrospectively to any balance sheet presented.

Effective dates are the subject of a separate discussion paper the results of which are likely to influence the effective date of these proposals. As a result, the exposure draft does not propose an effective date. However, we anticipate the final standard to have an effective date no earlier than 1 January 2013.

Am I affected?

These proposals primarily affect financial institutions that prepare their financial statements under US GAAP. Those entities would no longer have the ability to offset derivatives subject to master netting agreements, nor cash collateral and repos on the balance sheet. The offsetting proposal is largely consistent with IAS 32, 'Financial instruments: Presentation', so the main effect for IFRS preparers will relate to the additional disclosure requirements.

What do I need to do?

The comment letter period ends on 28 April 2011; a final standard is expected mid-2011. Management should consider commenting on the exposure draft to ensure their views on the proposals are considered.

If you have questions about this issue, please contact the PwC IFRS team or your engagement partner.

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