

To the Point

FASB – final guidance

New disclosures will enhance comparability between US GAAP and IFRS for offsetting of financial instruments.

Offsetting of financial instruments – new disclosures

What you need to know

- ▶ New disclosures will be required under US GAAP and IFRS to enable users of financial statements to reconcile the largest quantitative difference in balance sheets prepared under the two sets of standards.
- ▶ The existing US GAAP guidance allowing balance sheet offsetting, including industry-specific guidance, remains unchanged.
- ▶ The new disclosures are required for periods beginning on or after 1 January 2013, and must be applied retrospectively.

Overview

The new disclosure requirements in Accounting Standards Update (ASU) 2011-11¹ grew out of a joint project by the Financial Accounting Standards Board (FASB) and the International Accounting Standards Board (IASB) (collectively, the Boards) to create a converged offsetting model that would eliminate a significant quantitative difference between balance sheets prepared under US GAAP and IFRS.

The Boards initially proposed a model that would have been close to the more restrictive IFRS version, which results in more financial assets and financial liabilities being reported on the balance sheet than under US GAAP. But after some companies and regulators expressed concerns, the Boards decided against pursuing a joint model. Instead, they decided to focus on developing common disclosure requirements that would enable users of financial statements to reconcile the differences.

As a result, companies that report under US GAAP will continue to be able to offset certain financial instruments on their balance sheets, including certain derivatives and repurchase agreements subject to a master netting arrangement. Additionally,

certain industry-specific offsetting guidance for broker-dealers, construction companies and depository and lending institutions remains unchanged. This publication discusses the new requirements from a US GAAP perspective.²

Key considerations

Scope

New disclosures will be required for recognized financial instruments and derivative instruments that are either:

- ▶ Offset on the balance sheet in accordance with the offsetting guidance in ASC 210-20-45 or ASC 815-10-45 (collectively, the offsetting guidance)
- ▶ Subject to an enforceable master netting arrangement or similar agreement, regardless of whether they are offset in accordance with the offsetting guidance

Recognized assets and liabilities within the scope of the ASU include financial instruments such as derivatives, repurchase agreements, reverse repurchase agreements and securities lending and borrowing arrangements subject to master netting arrangements.

Financial instruments outside the scope of the ASU include loans and customer deposits at the same institution (unless they are offset in the statement of financial position) and financial instruments that are subject only to a collateral agreement (e.g., collateralized loans).

Quantitative disclosures

An entity will be required to disclose information to enable users of its financial statements to evaluate the effect or potential effect of netting arrangements on its financial position, including the effect or potential effect of rights of setoff associated with certain financial instruments and derivative instruments.

At a minimum, an entity will have to disclose at the end of the reporting period the following information separately for assets and liabilities:

- a) The gross amounts of those assets and liabilities
- b) The amounts offset in accordance with the offsetting guidance to determine the net amounts presented in the balance sheet
- c) The net amount presented in the balance sheet (i.e., (a) - (b))
- d) The amounts subject to an enforceable master netting arrangement or similar agreement that management either chooses not to offset or that do not meet the conditions in the offsetting guidance, along with the amounts related to cash and financial instrument collateral (whether recognized or unrecognized on the balance sheet)
- e) The net amount after deducting the amounts in (d) from the amounts in (c)

This information should be presented in tabular format unless another format is more appropriate. Importantly, the total amount disclosed in accordance with item (d) should not exceed the amount disclosed in accordance with item (c) for that instrument.

Entities should also describe the rights of setoff associated with recognized assets and recognized liabilities subject to an enforceable master netting arrangement or similar agreement (e.g., a derivative clearing agreement, a global master repurchase agreement) disclosed in accordance with item (d). For example, for a conditional right of setoff, an entity should describe the related condition(s). For any financial collateral received or pledged, an entity should describe the terms of the collateral agreement (e.g., when the collateral is restricted).

The disclosures may be grouped by type of instrument or transaction (e.g., derivatives, repurchase and reverse agreements, and securities borrowing and lending agreements). Alternatively, an entity may elect to disclose the information required by items (a) through (c) by type of financial instrument and the information required by items (c) through (e) by counterparty. Counterparties are not required to be identified by name. However, designation of the counterparties (e.g., Counterparty A, Counterparty B) should remain consistent from year to year to maintain comparability, and qualitative disclosures should be considered to give further information about the types of counterparties. When disclosure of the amounts required by items (c) through (e) is provided by counterparty, the amounts related to individually significant counterparties (relative to total counterparty amounts) should be separately disclosed, and the remaining individually insignificant counterparties should be aggregated into one line item.

If the disclosures involve financial instruments with different measurement attributes, such as a payable related to a repurchase agreement measured at amortized cost and a derivative measured at fair value, the entity should describe the resulting measurement differences in the disclosures. In addition, if the information required by the ASU is disclosed in more than a single note to the financial statements, an entity should cross-reference those notes.

Other considerations

Amounts offset in accordance with offsetting guidance

The amounts of recognized assets and recognized liabilities subject to setoff under the same arrangement will be disclosed in the respective tables, but the amounts included in those tables will be limited to the amount that is subject to setoff. If an entity has a recognized derivative asset and a recognized derivative liability that meet the offsetting guidance but the gross amount of the derivative asset is larger than the gross amount of the derivative liability, the entity would be able to report only the amount of the derivative asset that equals the amount of the derivative liability in the derivative liability disclosure table. The asset disclosure table would include the entire amount of the derivative asset and the entire amount of the derivative liability.

Limits on amounts disclosed for collateral not offset in the balance sheet

To prevent an entity from inappropriately obscuring information about undercollateralized financial instruments, the ASU says the amounts disclosed in accordance with item (d) should not exceed the amount disclosed in accordance with item (c).

The new guidance provides flexibility as to whether the required information is presented by type of financial instrument or by counterparty.

However, if the rights to collateral can be enforced across multiple contracts with the same counterparty (e.g., through a cross-collateralization arrangement), such rights may be included in the disclosure provided in accordance with item (d). That is, the collateral value may be allocated across multiple financial instruments, but the allocated collateral amount should never exceed the value of the related instrument.

Disclosure of the net amounts presented on the balance sheet

Entities will need to reconcile the amounts required in item (c) to the individual line item amounts presented in the balance sheet. For example, if an entity determines that the aggregation or disaggregation of individual balance sheet line items provides more relevant information, it must reconcile the aggregated or disaggregated amounts disclosed in accordance with item (c) to the balance sheet.

How we see it

Amounts netted due to specialized industry offsetting guidance (e.g., payables and receivables arising from unsettled regular-way trade by brokers and dealers) are beyond the scope of the new disclosure requirements and will continue to reduce comparability between balance sheets prepared under US GAAP and IFRS.

Effective dates and transition requirements

The disclosure requirements will be effective for periods beginning on or after 1 January 2013, and must be shown for all periods presented on the balance sheet (i.e., applied retrospectively).

Endnotes:

- ¹ FASB Accounting Standards Update No. 2011-11, *Balance Sheet (Topic 210): Disclosures about Offsetting Assets and Liabilities*
- ² On 16 December 2011, the IASB issued its disclosure guidance, *Disclosures – Offsetting Financial Assets and Financial Liabilities* (amendments to *IFRS 7, Financial Instruments: Disclosures*), as well as guidance clarifying IFRS offsetting requirements, *Offsetting Financial Assets and Financial Liabilities* (amendments to *IAS 32, Financial Instruments: Presentation*).

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