

Heads Up

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To better facilitate comparison between financial statements prepared under U.S. GAAP and IFRSs, the new disclosures will give financial statement users information about both gross and net exposures.

Finding Common Ground

FASB and IASB Issue New Balance Sheet Offsetting Disclosure Requirements

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Introduction

Last week, the FASB issued [ASU 2011-11](#),¹ which creates new disclosure requirements about the nature of an entity's rights of setoff and related arrangements associated with its financial instruments and derivative instruments. The disclosure requirements are effective for annual reporting periods beginning on or after January 1, 2013, and interim periods therein, with retrospective application required. The new disclosures are designed to make financial statements that are prepared under U.S. GAAP more comparable to those prepared under IFRSs. Generally, it is more difficult to qualify for offsetting under IFRSs than it is U.S. GAAP because under U.S. GAAP certain derivative and repurchase agreement arrangements are granted exceptions from the general offsetting model. As a result, entities with significant financial instrument and derivative portfolios that report under IFRSs typically present positions on their balance sheets that are significantly larger than those of entities with similarly sized portfolios whose financial statements are prepared in accordance with U.S. GAAP. To better facilitate comparison between financial statements prepared under U.S. GAAP and IFRSs, the new disclosures will give financial statement users information about both gross and net exposures.

This *Heads Up* outlines the scope and key provisions of ASU 2011-11 and discusses implementation considerations for the adoption of the new requirements. In addition, Appendixes A through C contain examples of the disclosures. On the same day the FASB issued the ASU, the IASB made similar amendments² to IFRS 7³ and also clarified certain aspects of IAS 32.⁴ Those changes are described in Appendix D.

Editor's Note: The FASB's issuance of this ASU represents the culmination of its joint offsetting project with the IASB, which had the original objective of converging the U.S. GAAP and IFRS offsetting models. However, since the boards could not agree on a single, converged offsetting presentation model, they ultimately voted to retain their existing offsetting models. Nonetheless, given (1) constituents' desire for convergence and improved comparability and (2) a general agreement that both gross and net information was useful for investors and other financial statement users, the FASB and IASB found some common ground in developing these new, expanded disclosure requirements.

¹ FASB Accounting Standards Update No. 2011-11, *Disclosures About Offsetting Assets and Liabilities*.

² *Disclosures — Offsetting Financial Assets and Financial Liabilities* (Amendments to IFRS 7) and *Offsetting Financial Assets and Financial Liabilities* (Amendments to IAS 32), both issued on December 19, 2011.

³ IFRS 7, *Financial Instruments: Disclosures*.

⁴ IAS 32, *Financial Instruments: Presentation*.

The ASU's new disclosure requirements may have a greater impact on entities that have not previously elected to offset because such entities may not separately track information for instruments with rights of setoff under enforceable master netting arrangements (or similar agreements).

Scope

As noted in the ASU, the new disclosure requirements apply to all entities with either of the following:

- Recognized financial instruments and derivative instruments that are offset in accordance with either ASC 210-20-45⁵ or ASC 815-10-45 (i.e., offset in accordance with the general offsetting model or the offsetting models for repurchase and reverse repurchase agreements and derivative arrangements and related cash collateral payables or receivables).
- Recognized financial instruments and derivative instruments that are subject to an enforceable master netting arrangement or similar agreement, irrespective of whether they are offset in accordance with either ASC 210-20-45 or ASC 815-10-45.

Examples of a "similar agreement" include (1) derivative clearing agreements, (2) global master repurchase agreements, and (3) global master securities lending agreements, as well as any related rights to financial collateral. Financial instruments and transactions that would fall within the scope of the disclosure requirements typically would include derivatives, repurchase and reverse repurchase agreements, and securities borrowing or lending agreements, but they would exclude (1) "[l]oans and customer deposits [held] at the same [financial] institution (unless they are offset in the statement of financial position)" and (2) "[f]inancial instruments that are only subject to a collateral agreement."

Editor's Note: Under U.S. GAAP, offsetting qualifying financial instruments on the balance sheet is elective (as an accounting policy choice). However, an entity that has any financial instruments or derivatives within the scope of the ASU must provide the new disclosures, regardless of whether it has elected to offset those instruments in the statement of financial position. Therefore, the ASU's new disclosure requirements may have a greater impact on entities that have not previously elected to offset because such entities may not separately track information for instruments with rights of setoff under enforceable master netting arrangements (or similar agreements).

Key Provisions

The ASU requires entities to disclose, at a minimum, the following information in tabular format (unless another format is more appropriate), separately for assets and liabilities:

- a. The gross amounts of those recognized assets and those recognized liabilities
- b. The amounts offset in accordance with the guidance in [ASC] 210-20-45 and 815-10-45 to determine the net amounts presented in the statement of financial position
- c. The net amounts presented in the statement of financial position
- d. The amounts subject to an enforceable master netting arrangement or similar agreement not otherwise included in (b):
 1. The amounts related to recognized financial instruments and other derivative instruments that either:
 - i. Management makes an accounting policy election not to offset.
 - ii. Do not meet some or all of the guidance in either [ASC] 210-20-45 or [ASC] 815-10-45.
 2. The amounts related to financial collateral (including cash collateral).
- e. The net amount after deducting the amounts in (d) from the amounts in (c).

To avoid the masking of undercollateralized positions by overcollateralized positions, the total amount that can be disclosed for a particular instrument in (d) above is limited to the amount that is disclosed in (c). In other words, collateral obtained (or posted) for a given instrument would only be disclosed in an amount up to 100 percent of the

⁵ For titles of *FASB Accounting Standards Codification* (ASC) references, see Deloitte's "Titles of Topics and Subtopics in the *FASB Accounting Standards Codification*."

When preparing to implement the standard, such entities should consider whether they have appropriate processes and internal controls in place to track, gather, and analyze the information they need to comply with new disclosure requirements.

instrument's net amount presented in the balance sheet.⁶ In addition, for each type of right of setoff disclosed in (d), an entity must also provide a narrative description of the nature of that right, such as how and when that right can be exercised.

The ASU provides two options for how entities may group the quantitative information disclosed for items (c) through (e) above. An entity may group information by type of instrument (e.g., derivatives and repurchase agreements and reverse repurchase agreements). Conversely, the entity may group the disclosures by counterparty. If the entity elects the counterparty option, it does not need to identify the names of specific counterparties; however, it should disclose individually significant counterparties separately, and it may group all other counterparties into a single amount. Entities making this election still must present the information in items (a) through (c) by type of instrument.

The ASU emphasizes the importance of reconciling the net amounts disclosed in item (c) to "the individual line item amount(s) presented in the statement of financial position." Such reconciliation must be provided regardless of the level of aggregation or disaggregation used for the disclosures.

Refer to Appendixes A through C for detailed examples of the new disclosures.

Effective Date and Transition

For all entities, the ASU is effective for fiscal years beginning on or after January 1, 2013, and interim periods within those annual periods. The guidance must be applied retrospectively for any period presented that begins before an entity's date of initial application.

Implementation Considerations

Operational Matters

As previously noted, some entities may not closely track information with respect to rights of setoff for financial instruments and derivative instruments executed under master netting arrangements or similar agreements. For example, such entities may (1) not have a significant volume of instruments that qualify for offsetting or (2) hold instruments that may qualify for offsetting but that elect to present those instruments gross in the statement of financial position. When preparing to implement the standard, such entities should consider whether they have appropriate processes and internal controls in place to track, gather, and analyze the information they need to comply with new disclosure requirements.

Interaction With Other U.S. GAAP

Under current U.S. GAAP, entities are already required to disclose information about certain amounts offset in the statement of financial position as well as information about related collateral (pledged or received) and other information about exposures to credit risk. For example, for derivative instruments, ASC 815-10-50-7 requires an entity to disclose its policy on offsetting while ASC 815-10-50-8 requires various disclosures about cash collateral payables and receivables under a master netting arrangement. The population of an entity's derivative instruments within the scope of ASU 2011-11 may be similar to those within the scope of the credit-risk-related contingent feature disclosure requirements of ASC 815-10-50-4H; however, differences also may exist because the scope of the new guidance is specific to recognized financial instruments that are offset in the statement of financial position or executed under a master netting arrangement or similar agreement. Therefore, entities should not assume that certain requirements of ASU 2011-11 are already met through disclosures they provide to meet existing requirements.

Editor's Note: ASU 2011-11 requires entities to include cross references if "the information required . . . is disclosed in more than a single note to the financial statements."

⁶ Note that the ASU adds ASC 210-20-55-13, which clarifies that rights to collateral that "can be enforced across financial instruments" also may be included in the amounts disclosed in (d); however, the ASU emphasizes that undercollateralized positions should not be obscured in the disclosure.

Appendix A — Example of Disclosure by Financial Instrument Type

The tables below are reprinted from ASU 2011-11. This example illustrates the application of ASC 210-20-50-3(a)–(e) by type of financial instrument. Refer to ASU 2011-11 for additional detail.

Offsetting of Financial Assets and Derivative Assets

\$ Million						
As of December 31, 20XX	(i)	(ii)	(iii) = (i) – (ii)	(iv)		(v) = (iii) – (iv)
Description	Gross Amounts of Recognized Assets	Gross Amounts Offset in the Statement of Financial Position	Net Amounts of Assets Presented in the Statement of Financial Position	Gross Amounts Not Offset in the Statement of Financial Position		
				Financial Instruments	Cash Collateral Received	Net Amount
Derivatives	\$ 100	\$ (90)	\$ 10	\$ —	\$ —	\$ 10
Reverse repurchase, securities borrowing, and similar arrangements	90	—	90	(90)	—	—
Other financial instruments	—	—	—	—	—	—
Total	<u>\$ 190</u>	<u>\$ (90)</u>	<u>\$ 100</u>	<u>\$ (90)</u>	<u>\$ —</u>	<u>\$ 10</u>

Offsetting of Financial Liabilities and Derivative Liabilities

\$ Million						
As of December 31, 20XX	(i)	(ii)	(iii) = (i) – (ii)	(iv)		(v) = (iii) – (iv)
Description	Gross Amounts of Recognized Liabilities	Gross Amounts Offset in the Statement of Financial Position	Net Amounts of Liabilities Presented in the Statement of Financial Position	Gross Amounts Not Offset in the Statement of Financial Position		
				Financial Instruments	Cash Collateral Pledged	Net Amount
Derivatives	\$ 80	\$ (80)	\$ —	\$ —	\$ —	\$ —
Repurchase, securities lending, and similar arrangements	80	—	80	(80)	—	—
Other financial instruments	—	—	—	—	—	—
Total	<u>\$ 160</u>	<u>\$ (80)</u>	<u>\$ 80</u>	<u>\$ (80)</u>	<u>\$ —</u>	<u>\$ —</u>

Appendix B — Example of Disclosure by Financial Instrument Type and Counterparty

The tables below are reprinted from ASU 2011-11. This example illustrates the application of ASC 210-20-50-3(a)–(c) by type of financial instrument and ASC 210-20-50-3(c)–(e) by counterparty. Refer to ASU 2011-11 for additional detail.

Offsetting of Financial Assets and Derivative Assets

\$ Million			
As of December 31, 20XX	(i)	(ii)	(iii) = (i) – (ii)
	Gross Amounts of Recognized Assets	Gross Amounts Offset in the Statement of Financial Position	Net Amounts of Assets Presented in the Statement of Financial Position
Description			
Derivatives	\$ 100	\$ (90)	\$ 10
Reverse repurchase, securities borrowing, and similar arrangements	90	—	90
Other financial instruments	—	—	—
Total	<u>\$ 190</u>	<u>\$ (90)</u>	<u>\$ 100</u>

Financial Assets, Derivative Assets, and Collateral Held by Counterparty

\$ Million				
As of December 31, 20XX	(iii)	(iv)		(v) = (iii) – (iv)
	Net Amounts of Assets [Presented] in the Statement of Financial Position	Gross Amounts Not Offset in the Statement of Financial Position		Net Amount
		Financial Instruments	Cash Collateral Received	
Counterparty A	\$ 10	\$ —	\$ —	\$ 10
Counterparty B	90	(90)	—	—
Other	—	—	—	—
Total	<u>\$ 100</u>	<u>\$ (90)</u>	<u>\$ —</u>	<u>\$ 10</u>

Offsetting of Financial Liabilities and Derivative Liabilities

\$ Million			
As of December 31, 20XX	(i)	(ii)	(iii) = (i) – (ii)
	Gross Amounts of Recognized Liabilities	Gross Amounts Offset in the Statement of Financial Position	Net Amounts of Liabilities Presented in the Statement of Financial Position
Description			
Derivatives	\$ 80	\$ (80)	\$ —
Repurchase, securities lending, and similar arrangements	80	—	80
Other financial instruments	—	—	—
Total	<u>\$ 160</u>	<u>\$ (80)</u>	<u>\$ 80</u>

Financial Liabilities, Derivative Liabilities, and Collateral Pledged by Counterparty

\$ Million				
As of December 31, 20XX	(iii)	(iv)		(v) = (iii) – (iv)
	Net Amounts of Liabilities Presented in the Statement of Financial Position	Gross Amounts Not Offset in the Statement of Financial Position		
		Financial Instruments	Cash Collateral Pledged	Net Amount
Counterparty A	\$ —	\$ —	\$ —	\$ —
Counterparty B	80	(80)	—	—
Other	—	—	—	—
Total	<u>\$ 80</u>	<u>\$ (80)</u>	<u>\$ —</u>	<u>\$ —</u>

Appendix C — Example of a Sophisticated Entity Disclosure by Financial Instrument Type and Counterparty

The example below, adapted from ASU 2011-11, illustrates how a sophisticated entity that engages in significant derivative activity may display the disclosures required by ASC 210-20-50-3(a)–(c) by type of financial instrument and ASC 210-20-50-3(c)–(e) by counterparty. The adapted example below illustrates only certain derivative instruments and includes only the asset table. See ASU 2011-11 for the complete example.

Offsetting of Financial Assets and Derivative Assets

\$ Million			
As of December 31, 20XX	(i)	(ii)	(iii) = (i) – (ii)
	Gross Amounts of Recognized Assets	Gross Amounts Offset in the Statement of Financial Position	Net Amounts of Assets Presented in the Statement of Financial Position
Description			
Derivatives			
Interest rate contracts			
Over the counter	\$ XX,XXX	\$ XX,XXX	\$ XX,XXX
Exchange traded	XX,XXX	XX,XXX	XX,XXX
Exchange cleared	XX,XXX	XX,XXX	XX,XXX
Commodity contracts			
Over the counter	XX,XXX	XX,XXX	XX,XXX
Exchange traded	XX,XXX	XX,XXX	XX,XXX
Exchange cleared	XX,XXX	XX,XXX	XX,XXX
Total derivatives, subject to a master netting arrangement or similar arrangement	<u>XX,XXX</u>	<u>XX,XXX</u>	<u>XX,XXX</u>
Total derivatives, not subject to a master netting arrangement or similar arrangement	<u>XX,XXX</u>	<u>XX,XXX</u>	<u>XX,XXX</u>
Total derivatives	<u>XX,XXX</u>	<u>XX,XXX</u>	<u>XX,XXX</u>
Reverse repurchase, securities borrowing, and similar arrangements	<u>XX,XXX</u>	<u>XX,XXX</u>	<u>XX,XXX</u>
Other financial instruments	<u>XX,XXX</u>	<u>XXXXXX</u>	<u>XX,XXX</u>
Total	<u>\$ XX,XXX</u>	<u>\$ XX,XXX</u>	<u>\$ XX,XXX</u>

Financial Assets, Derivative Assets, and Collateral Held by Counterparty

\$ Million				
As of December 31, 20XX	(iii)	(iv)		(v) = (iii) – (iv)
	Net Amounts of Assets [Presented] in the Statement of Financial Position	Gross Amounts Not Offset in the Statement of Financial Position		Net Amount
		Financial Instruments	Cash Collateral Received	
Counterparty A	\$ XX,XXX	\$ XX,XXX	\$ XX,XXX	\$ XX,XXX
Counterparty B	XX,XXX	XX,XXX	XX,XXX	XX,XXX
Other	<u>XX,XXX</u>	<u>XX,XXX</u>	<u>XX,XXX</u>	<u>XX,XXX</u>
Total	<u>\$ XX,XXX</u>	<u>\$ XX,XXX</u>	<u>\$ XX,XXX</u>	<u>\$ XX,XXX</u>

Appendix D — Amendments to IFRSs

Amendments to IFRS 7

On the same day the FASB issued ASU 2011-11, the IASB issued amendments to IFRS 7 that require essentially the same disclosures as those required by ASU 2011-11. The effective date for those amendments is also for annual periods beginning on or after January 1, 2013, and interim periods therein, with retrospective application required.

Amendments to IAS 32

During deliberations in the offsetting project, the IASB became aware of diversity in the application of certain provisions of the offsetting guidance IAS 32. Thus, in addition to issuing the new converged disclosure requirements in IFRS 7, the IASB amended IAS 32 to clarify those provisions.

One criterion for offsetting under the IASB model is that “an entity must currently have a legally enforceable right of set-off” for the recognized amounts. One amendment clarified that such a right:

- (a) must not be contingent on a future event; and
- (b) must be legally enforceable in all of the following circumstances:
 - (i) the normal course of business;
 - (ii) the event of default; and
 - (iii) the event of insolvency or bankruptcy of the entity and all of the counterparties.

The IASB also provided additional application guidance to clarify when the mechanisms of a gross settlement system may be considered equivalent to net settlement (in the context of paragraph 42(b) of IAS 32, which permits offsetting only when an entity “intends either to settle on a net basis, or to realise the asset and settle the liability simultaneously”). The amendment cites an example of the characteristics of a gross settlement system that would meet this net settlement criterion.

The amendments to IAS 32 are effective for annual periods beginning on or after January 1, 2014. Retrospective application is required, with early application permitted. In addition, an entity that chooses to early adopt the amendments to IAS 32 also must provide the disclosures required by the amendments to IFRS 7.

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