Are you caught in the 'offsetting' net?

Updates by the IASB and the FASB have several implications for Cayman Islands-based funds, as Ben Leung and Rennie Khan explain.

The International Accounting Standards Board (IASB) and the Financial Accounting Standards Board (FASB) have soldiered on with their joint deliberations and produced the following updates:

IFRS	US GAAP
Disclosures—Offsetting Financial Assets and Financial Liabilities (Amendments to IFRS 7)	ASU 2011-11 Balance Sheet (Topic 210)—Disclosures about Offsetting Assets and Liabilities. ASU 2013-01 Balance Sheet (Topic 210)—Clarifying the Scope of Disclosures about Offsetting Assets and Liabilities
Effective for annual reporting periods beginning on or after January 1, 2013 with retrospective application, ie, prior year disclosures are required.	Effective for annual reporting periods beginning on or after January 1, 2013. If prior year comparatives are disclosed, retrospective application is required.

What are the requirements?

The requirements under International Financial Reporting Standards (IFRS) and US generally accepted accounting principles (GAAP) are almost identical and are required when there is netting on the balance sheet, or when there is the ability to net under an enforceable master netting arrangement or similar agreement.

The types of transactions that will typically result in this additional disclosure are:

- Derivatives;
- Sale and repurchase agreements;
- Reverse sale and repurchase agreements;
- Securities borrowing; and
- Securities lending.

The disclosures are best made in tabular format as in the following example and are required for both financial assets and financial liabilities.

	Asset	Liability	Collateral received	Collateral pledged
Counterparty A—Derivative	$100*	$80*	$10+#	
Counterparty B—Derivative	$100+	$80+	$20+#	
Counterparty C—Repo	$90+	$80+	$105+@	$85+@

Key

*	Netted on the balance sheet
+	Not netted on the balance sheet but has the ability to net according to the agreement with each counterparty
#	Cash collateral
@	Collateral in bonds

Financial assets

Required disclosures (columns below)

(a) Gross amount of recognised financial assets.

(b) Gross amount of recognised financial liabilities set off in the balance sheet.

(c) Net amount of financial assets presented in the balance sheet.

(d) Related amounts not set off in the balance sheet:
(d)(i)—Financial instruments
(d)(ii)—Cash collateral received

(e) Net amount.

	(a)	(b)	(c) = (a)-(b)	(d)		(e)= (c)-(d)
				(i)	(ii)	
Derivatives	$200	($80)	$120	($80)	($30)	$10
Repos	$90	-	$90	($90)	-	-
Other	-	-	-	-	-	-
Total	$290	($80)	$210	($170)	($30)	$10

Financial liabilities

(a) Gross amount of recognised financial liabilities.

(b) Gross amount of recognised financial assets set off in the balance sheet.

(c) Net amount of financial liabilities presented in the balance sheet.

(d) Related amounts not set off in the balance sheet:
(d)(i)—Financial instruments
(d)(ii)—Cash collateral pledged

(e) Net amount.

	(a)	(b)	(c) = (a)-(b)	(d)		(e)= (c)-(d)
				(i)	(ii)	
Derivatives	$160	($80)	$80	($80)	-	-
Repos	$80	-	$80	($80)	-	-
Other	-	-	-	-	-	-
Total	$240	($80)	$160	($160)	-	-

Notes from the above:

1. If there is no netting then column (b) equals $0 and columns (a) and (c) are the same.
2. Column (e) cannot be below $0, therefore the total in column (d) is limited to the total in column (c).

Alternative disclosure for columns (c) through (e)

IFRS and US GAAP both allow columns (c) through (e) to be disclosed by counterparty, with columns (a) to (c) remaining the same as above.

Financial assets

	(c)	(d)		(e)= (c)-(d)
		(i)	(ii)	
Counterparty A	$20	-	($10)	$10
Counterparty B	$100	($80)	($20)	-
Counterparty C	$90	($90)	-	-
Total	$210	($170)	($30)	$10

Financial liabilities

	(c)	(d)		(e)= (c)-(d)
		(i)	(ii)	
Counterparty A	-	-	-	-
Counterparty B	$80	($80)	-	-
Counterparty C	$80	($80)	-	-
Total	$160	($160)	-	-

Notes on the above:

1. Counterparties are not required to be identified by name.
2. Designation of a counterparty (A,B,C) should be consistent from year to year.
3. Significant counterparty amounts should be separately disclosed; individually insignificant counterparty amounts can be aggregated into one line.

Other disclosure requirements

1. An entity shall include a description in the disclosure notes of the rights of set-off associated with the entity's recognised financial assets and recognised financial liabilities subject to enforceable master netting arrangements and similar agreements that are disclosed in accordance with (d—Related amounts not set off in the balance sheet), including the nature of those rights.
2. For any financial collateral received or pledged, the entity shall describe the terms of the collateral agreement (eg, restrictions).

Exemptions from the above disclosure requirements:

1. Loans and customer deposits at the same institution (unless they are offset on the balance sheet); and
2. Financial instruments that are subject only to a collateral agreement.

Conclusion

Depending on the trading strategy of the fund, the above can lead to review and analysis of multiple agreements and documents. We recommend that this be one of the first disclosures completed for the notes to the financial statements, especially for an IFRS fund which requires comparative statements to be disclosed (not a requirement for a US GAAP fund). ■

Ben Leung is the managing partner of PKF (Cayman). He has more than 15 years of accounting and auditing experience. He has specialised in the audits of Cayman-based mutual funds and captive insurance companies.

Rennie Khan (FCCA) is the technical partner at PKF (Cayman). He has more than 15 years of accounting experience, including 12 years in the Cayman Islands. Prior to joining the firm, he served with another major accounting firm in Trinidad and Tobago and the Cayman Islands. He gained his experience working on audits of investment funds, private banks, insurance captives and trust companies.