

New Disclosure Requirements for Offsetting Financial Instruments

The Financial Accounting Standards Board (FASB) and International Accounting Standards Board (IASB) continued to make progress on their convergence project with the recent release of Accounting Standards Update (ASU) 2011-11, December 2011. Although the update stops short of requiring similar balance sheet treatment for financial instruments and derivatives by the Boards – Generally Accepted Accounting Principles (GAAP) in the U.S. have less restrictive offsetting guidance than International Financial Reporting Standards (IFRS) – the ASU does bolster disclosure requirements so financial statement users can understand a fund's net and gross exposures associated with such instruments. The ASU is effective for annual reporting periods beginning on or after January 1, 2013, with interim periods therein, and is to be implemented retrospectively.



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Scope

The ASU affects all entities that have financial instruments or derivative instruments (and related cash collateral, payables or receivables) that are offset in accordance with GAAP or are subject to a master netting arrangement or other similar agreement. In general, recognized assets and liabilities may include derivatives, repurchase agreements and reverse repurchase agreements, and security borrowing and security lending agreements.

Key Considerations

Mutual funds and other SEC registered investment companies currently provide detailed disclosures of all financial instruments and derivatives; however, the ASU does not exempt any entity from the new quantitative disclosure requirements.

GAAP permits presenting qualifying assets and liabilities on the statement of position on a net basis as an elective accounting policy should the financial instruments or derivatives meet certain criteria. ASU 2011-11 requires additional disclosures if a fund presents qualifying assets and liabilities on a net basis or if the fund has financial instruments and derivatives subject to a master netting arrangement, regardless of whether or not management elects to offset. Therefore, complying with the ASU may require entities that typically don't monitor information on a net basis to implement additional controls in order to capture sufficient data to provide the disclosures required. Specifically, funds will likely need to analyze and document contracts and netting arrangements with counterparties as well as current settlement systems. Also important to note is that the quantitative disclosures are required for interim periods beginning after the effective date of January 1, 2013, so it will be crucial to have the processes and controls in place prior to that date.

Quantitative Disclosures

The following is required to be disclosed in a tabular format separately for assets and liabilities that are within the scope of this ASU:

- a. The gross amounts of those recognized assets and liabilities.
- b. The amounts currently offset in accordance with the applicable guidance, 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 (a – b).
- 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 applicable guidance in ASC 210-20-45 or 815-10-45.
 2. The amounts related to financial collateral (including cash collateral).
- e. The net amount after deducting the amounts in (d) from (c)

Additional Disclosures

In addition to the tabular disclosures noted above, funds should provide a description and the nature of the right to offset associated with a fund's recognized assets and liabilities that are subject to a master netting arrangement. Also, if the required disclosures are made in multiple notes to the financial statements, the fund should include cross references to all applicable notes containing the required disclosures prescribed by this ASU.