Institute of Chartered Accountants of New Zealand

FINANCIAL REPORTING STANDARD NO. 27
1994

RIGHT OF SET-OFF

Issued by the Financial Reporting Standards Board
Institute of Chartered Accountants of New Zealand

Approved March 1994 by the Accounting Standards Review Board
under the Financial Reporting Act 1993

CONTENTS

This Standard replaces SSAP-27: Right of Set-off (1990), although that Statement will continue to apply until the completion of accounting periods which end prior to 1 July 1994.

This Standard should be read in the context of the Explanatory Foreword to General Purpose Financial Reporting published by the Council, Institute of Chartered Accountants of New Zealand.

The Accounting Standards Review Board has approved FRS-27: Right of Set-off, for the purposes of the Financial Reporting Act 1993, to apply to reporting entities, the Crown and all departments, Offices of Parliament and Crown entities (each of which is defined in the Act).

Notice is hereby given (7 October 1994), pursuant to section 29 of the Financial Reporting Act 1993 ("the Act") that the Accounting Standards Review Board has determined that Financial Reporting Standard No 27: Right of Set-off, of the New Zealand Society of Accountants, *which has been previously approved by the Board for the purposes of the Act shall cease to apply to life insurance companies (as defined in the Life Insurance Act 1908) in respect of accounting periods and interim accounting periods that end on or after 30 November 1994.*

The Board has also approved this Standard to apply to local authorities (as defined in the Act) from 1 July 1998.

1 INTRODUCTION

COMMENTARY

1.1 This Standard deals with the circumstances in which:

(a) assets and liabilities, and

(b) revenues and expenses

may be set off in the presentation of financial reports.

1.2 This Standard covers the circumstances in which it is appropriate for amounts of assets and liabilities to be set off in the statement of financial position. The set-off of assets and liabilities should not be confused with the extinguishment of debt; extinguishment of debt is dealt with in FRS-26: *Accounting for Defeasance*. Set-off is a disclosure issue, that is, how recognised assets and recognised liabilities are to be presented in a statement of financial position. In contrast, extinguishment is a recognition issue, that is, whether an asset or liability exists and whether continued recognition is warranted in the statement of financial position.

1.3 Financial reporting standards are paragraphs in bold type-face in this Standard. Where appropriate, interpretive commentary paragraphs in plain type-face follow the financial reporting standards.

2 APPLICATION

STANDARD

2.1 This Standard applies to the general purpose financial reports of all entities.

2.2 The financial reporting standards set out in this Standard shall apply to all financial reports where such application is of material consequence. A statement, fact, or item is material if it is of such a nature or amount that its disclosure, or the method of treating it, given full consideration of the circumstances applying at the time the financial report is completed, is likely to influence the users of the financial report in making decisions or assessments.

2.3 Where set-off is required or permitted by other Financial Reporting Standards, the other Financial Reporting Standards shall prevail. The set-off of items in the statement of cash flows is dealt with in FRS-10: *Statement of Cash Flows*.

2.4 This Standard applies to general purpose financial reports covering periods ending on or after 1 July 1994.

3 STATEMENT OF PURPOSE

COMMENTARY

3.1 The purpose of this Standard is to:

(a) establish the conditions under which:
  - (i) assets and liabilities may be set off in the statement of financial position, and
  - (ii) revenues and expenses may be set off in the statement of financial performance; and

(b) require appropriate disclosures.

4 DEFINITIONS

STANDARD

The following terms are used in this Standard with these meanings:

4.1 "Monetary assets" are items held or to be received in money where the amounts to be received are fixed. "Monetary assets" include:

- **cash**
- **bank balances**
- **accounts receivable**
- **bills receivable**
- **term deposits.**

"Monetary assets" may include such assets denominated in foreign currency.

4.2 "Monetary liabilities" are items to be paid in money where the amounts to be paid are fixed. "Monetary liabilities" include:

- **bank overdrafts**
- **accounts payable**
- **bills payable**
- **term loans.**

"Monetary liabilities" may include such liabilities denominated in foreign currency.

4.3 "Parties" means accounting entities. The term is not restricted to legal entities but includes partnerships and consolidated corporate entities.

4.4 "Right of set-off" means that right which exists when:

(i) parties to an agreement owe each other fixed amounts of money; and

(ii) the parties acknowledge (in writing or through common practice) the right to set off amounts owed to and owing from other parties to the agreement; and

(iii) the entity intends to set off; and

(iv) the right to set off is enforceable at law.

4.5 "Set-off" is the presentation of the reduction of an asset by a liability or of a liability by an asset so that the net amount only is disclosed.

5 FINANCIAL REPORTING

Set-off of Monetary Assets and Liabilities

STANDARD

5.1 Assets and liabilities shall not be set off in the presentation of the statement of financial position except as provided in paragraph 5.2.

5.2 Where there is a right of set-off for monetary assets and monetary liabilities, those monetary assets and monetary liabilities need not be disclosed separately but may be set off in the presentation of the statement of financial position.

COMMENTARY

5.3 When assets and liabilities are separately displayed, users of the statement of financial position can better assess the future benefits and obligations of the entity. Set-off of monetary assets and monetary liabilities is permissible, but not compulsory if there is a right of set-off as defined.

5.4 The nature of the security (if any) for a debt or restrictions on recourse (if any) of a debt do not of themselves determine whether assets and liabilities are able to be set off or are to be shown separately in the statement of financial position.

5.5 As a rule, the mere existence of a two-way debtor/creditor relationship between two parties does not give rise to a right of set-off. The right to set-off must be enforceable at law.

5.6 A right of set-off enforceable at law may arise under either:

(a) contract law — where parties to the agreement explicitly acknowledge a right to set-off; or

(b) common law — through traditional acceptance of a right of set-off and the practice of doing so.

In either case, the legal right of set-off, to be recognised as such, must be enforceable in a liquidation or bankruptcy.

5.7 To be set off, monetary assets and monetary liabilities must both meet the usual criteria for recognition and therefore, but for the set-off, would be presented separately in the statement of financial position.

5.8 A right of set-off will exist for deposits and advances arising under swap agreements only where all the parties involved acknowledge that a right of set-off exists among them.

5.9 Asset securitisation normally will not qualify for set-off. Securitisation is more likely to give rise to an outright sale than to a right of set-off.

5.10 In a group financial report, the controlling entity need not reinstate assets and liabilities set-off in the financial report of a controlled entity. The right of set-off of the controlled entity remains effective for the group financial report.

Set-off of Revenues and Expenses

STANDARD

5.11 Where monetary assets and monetary liabilities have been set off in accordance with this Standard, any revenues and expenses derived from those assets and liabilities shall be set off in the statement of financial performance.

COMMENTARY

5.12 Where monetary assets and liabilities are set off in the statement of financial position, it is necessary to set off revenues and expenses associated with those assets and liabilities in order to preserve consistency between the components of the statement of financial position and the statement of financial performance. For example, the interest revenue derived from the monetary assets and interest expense derived from the monetary liabilities are to be set off. This is to be contrasted with the revenues and expenses that gave rise to the monetary assets and monetary liabilities in the first instance, which should not be set off.

Disclosure

STANDARD

5.13 There shall be disclosed by way of note:

(a) where risk attaches to the monetary assets or monetary liabilities set off:

- **(i) the amounts of the assets and liabilities set off;**
- **(ii) the nature of risk attaching to the assets and liabilities set off; and**
- **(iii) the revenues and expenses related to the assets and liabilities set off.**

(b) details of any other assets and liabilities where a right of set-off exists in terms of paragraph 4.4 but those assets and liabilities have not been set off in the financial report; and

(c) where the entity is party to an agreement to set off under certain circumstances in the future, details of assets and liabilities subject to the future right of set-off.

COMMENTARY

5.14 In general, where the set-off criteria are met, there is no requirement to disclose the assets and liabilities, and revenues and expenses, which have been set off. However, where risk factors remain, such as where assets and liabilities are denominated in different currencies or where different interest rates apply, the risk factors and the assets and liabilities set off are to be disclosed by note to the financial report.

5.15 Details are to be given of assets and liabilities where a right of set-off exists but those assets and liabilities have not been set off. This is to inform users of the financial report of the potential to set off.

5.16 The note disclosure in paragraph 5.13(c) is to be required even though a right of set-off does not currently exist and the assets and liabilities continue to be presented separately in the financial report.

APPENDIX

Comparison of FRS-27 with International and Australian Accounting Standards

This comparison appendix, which was prepared as at 1 March 1994 and deals only with significant differences in the standards, is produced for information purposes only and does not form part of the standards in FRS-27. The International Accounting Standards Committee has not issued a standard equivalent to FRS-27.

The Australian accounting standards comparable with FRS-27 are:

- AASB 1014: *Set-off and Extinguishment of Debt*; and
- AAS-23: *Set-off and Extinguishment of Debt.*

There is substantial agreement among these accounting standards. However, the Australian standards combine set-off and extinguishment of debt whereas these two issues are dealt with separately in the New Zealand Financial Reporting Standards, FRS-26 and FRS-27.

The following summarises the main differences between the New Zealand and Australian standards as regards the right of set-off.

Subject Matter of the Standard

AASB 1014 and AAS-23 allow the set-off of assets and liabilities generally. FRS-27 permits the set-off of only monetary assets and monetary liabilities.

Right of Set-off

The conditions for right of set-off are the same in both standards except that:

- FRS-27 requires that the parties acknowledge (in writing or through common practice) the right of set-off of each party; and
- AASB 1014 and AAS-23 instead refer to that right which allows the reporting entity to off set the amount owed against the amount owing by the other entity.

Revenues and Expenses

FRS-27 requires the set-off of revenues and expenses derived from monetary assets and liabilities that have been set off. AASB 1014 and AAS-23 do not have a similar provision.

Disclosure

AASB 1014 and AAS-23 do not have any disclosure requirements concerning set-offs. FRS-27 has specific disclosure requirements concerning outstanding risks, items that have met the criteria for set-off but have not been set off, and assets and liabilities which are subject to a right of set-off in the future.

HISTORY

Previously issued accounting standards superseded by this Financial Reporting Standard:

SSAP-27: Right of Set-off (issued October 1990 and effective for periods commencing on or after 1 April 1991).