IFRS

STAFF PAPER

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IFRS Interpretations Committee Meeting

Project	**New items for initial consideration**		
Paper topic	IAS 32—Offsetting in respect of certain cash pooling arrangements		
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Introduction

1. The IFRS Interpretations Committee ('the Interpretations Committee') has received a request to address an issue related to IAS 32 *Financial Instruments: Presentation*.

2. The issue relates to whether certain cash pooling arrangements would meet the requirements for offsetting under IAS 32.

3. The objective of this agenda paper is to provide the Interpretations Committee with a summary of the issue, along with the staff's research, analysis and recommendation.

4. The submission is reproduced in full in Appendix B to this agenda paper.

Structure of the agenda paper

5. This paper is organised as follows:

    (a) background information;

    (b) summary of outreach conducted;

(c) relevant accounting requirements;

(d) staff analysis;

(e) assessment against the Interpretations Committee's agenda criteria;

(f) staff recommendation;

(g) questions for the Interpretations Committee;

(h) Appendix A—Proposed wording for the tentative agenda decision; and

(i) Appendix B—Submission.

Background Information

The issue

6. In accordance with paragraph 42 of IAS 32, an entity is required to offset a financial asset and a financial liability in the following circumstances:

> **42** A financial asset and a financial liability shall be offset and the net amount presented in the statement of financial position when, and only when, an entity:
>
> (a) currently has a legally enforceable right to set off the recognised amounts; and
>
> (b) intends either to settle on a net basis, or to realise the asset and settle the liability simultaneously.

7. The submitter observes that cash pooling arrangements are often put in place in situations in which a number of subsidiaries within a group each have legally separate bank accounts, some of which will have a positive cash balance and

others have a negative (overdraft) balance. Specifically, the submitter describes a notional pooling arrangement that has the following key features:

(a) interest is calculated on the net balance of all the separate bank accounts;

(b) there are regular transfers of balances into a single netting account. However:

   (i) this is not required under the terms of the arrangement;

   (ii) this is not done at the reporting date; and

   (iii) the amounts that will be set off in the future are not necessarily known at the reporting date, because the balances at the reporting date may subsequently change as group entities place further cash on deposit or withdraw cash to settle other obligations; and

(c) the bank and the group (as constituted by all legal parties to the arrangement within the group) have the necessary legally enforceable right to set these balances off under paragraph 42(a) of IAS 32 at the reporting date.

8. The submitter asks what the appropriate accounting treatment is for this transaction by the group. Specifically, the submitter asks whether the regular transfers of balances into a netting account (but not at the reporting date) are sufficient to demonstrate an intention to settle the period-end balances on a net basis for the purpose of meeting the requirement in paragraph 42(b) of IAS 32.

9. The submitter considers that there is currently diversity in practice relating to this matter and identifies the following two views:

View 1—Yes

10. Proponents of this view believe that when there are regular net cash settlement of the accounts (but not at the reporting date), the requirements of paragraph 42(b) of IAS 32 are met for the group, because in their view, the regular practice demonstrates the intention to settle on a net basis.

View 2—No

11. Proponents of this view believe that when there is regular net cash settlement of the accounts (but not at the reporting date), this is not sufficient for the group to meet the offsetting requirements of paragraph 42(b) of IAS 32. In their view, there must be an intention at the reporting date to net settle the specific balances outstanding. In the example presented by the submitter, the positive and negative cash balances will rise and fall in line with the cash requirements of individual subsidiaries within the group rather than being used to offset one another. Consequently, the intention to net settle specific balances at the reporting date cannot be demonstrated.

Summary of outreach conducted

12. In order to gather information about the issue described in the submission, we sent requests to members of the International Forum of Accounting Standard-Setters (IFASS), groups of securities regulators, and the global IFRS technical teams of the international networks of the large accounting firms ('large firms'). Specifically, we asked:

    (a) *Question 1: In your jurisdiction, are notional pooling arrangements of the type described in the submission commonly observed?*

    (b) *Question 2: If you answer 'yes' to Question 1, what is the predominant accounting treatment for such arrangements? In addition:*

        (i) *could you please describe the rationale for that accounting treatment; and*

        (ii) *if possible, please provide examples of the predominant approach you observe. Ideally, this should be examples from publicly available financial statements, but those on a confidential basis would also be helpful.*

    (c) *Question 3: On the basis of your response to Question 2, to what extent do you observe diversity in the accounting treatment?*

13. In total, we received 14 responses. The views received represent informal opinions and do not reflect the formal views of those organisations.

14. We received 8 responses from IFASS members who had sought the views of their constituents. However, a number of IFASS members commented that they had not received many responses from their constituents. The geographical breakdown for the responses received is as follows:

Geographical region	Number of respondents
Asia	3
Europe	1
Americas	2
Oceania	1
Africa	1
Total respondents	**8**

15. We also received responses from two groups of securities regulators. Both securities regulators sought the views of individual national regulators across various jurisdictions. Similarly to the case with some IFASS members, one securities regulator noted that they had not received many responses from their constituents.

16. Finally, we received responses from four large firms who had consulted with firms in their international network.

17. The feedback received can be summarised as follows:

    (a) while a number of respondents noted that cash pooling arrangements were common, it was not clear whether the specific type of notional cash pooling arrangement described by the submitter was common;

    (b) there were mixed views regarding the predominant accounting treatment. A number of IFASS members were of the view that the example presented would not meet the offsetting requirements of IAS 32 whereas most of the large firms considered that the offsetting requirements could be met, but that this would require judgement and depend on the frequency of cash transfers; and

(c) many respondents noted that they had either observed existing diversity in practice or if not, that it was likely given the many different types of cash pooling arrangements.

18. Many respondents observed that there were several different types of cash pooling arrangements and many different mechanisms for applying these arrangements in practice. Consequently, they noted that the appropriate accounting treatment would depend on the individual facts and circumstances of each case.

19. While a number of respondents observed that the practice of cash pooling was common, some presented examples different to that which was set out by the submitter and consequently, it was not clear whether the specific notional cash pooling arrangement described by the submitter was common.

20. Some respondents, in particular securities regulators, observed that entities did not often disclose the specific type of cash pooling arrangements that they were involved in, which made it difficult to conclude on whether a particular type of cash pooling arrangement was common.

21. As regards the most appropriate accounting treatment, views were mixed among respondents.

22. The majority of respondents who considered that offsetting would be appropriate agreed with the argument put forward by proponents of View 1 in the submission. In their view, cash settlement at the reporting date would not be required, because the practice of regular cash settlements was sufficient to demonstrate an intention to settle on a net basis, and so, in their view, the requirements of paragraph 42(b) of IAS 32 were met. However, a number of those respondents highlighted that judgement would be required in order to determine whether the practice of regular cash settlements was sufficient to demonstrate an intention to settle on a net basis

and consequently it would be necessary to consider the specific facts of circumstances of each case.

23. In contrast, respondents who considered that the offsetting would not be appropriate (ie View 2 in the submission) were of the opinion that the practice of regular cash settlement was not sufficient to demonstrate an intention to settle on a net basis and cited the following reasons:

    (a) the intention to settle net could not be demonstrated, because the entity does not know the amount that will be offset. This is because each entity in the group has a separate legal bank account and operates its account independently according to its own business needs. Consequently, positive balances may be used to settle obligations with other counterparties rather than to settle negative balances on other bank accounts within the cash pooling arrangement; and

    (b) it is not possible to conclude on the future intention to settle net based merely on past practice.

24. In the view of those respondents, physical cash settlement would be required in order to demonstrate an intention to settle on a net basis. One respondent observed that in their particular jurisdiction, the physical transfer of cash would have to be a legal requirement of the cash pooling arrangement in order for the balances to be offset in accordance with local regulatory requirements.

25. Some respondents noted that care needed to be taken when assessing the substance of cash sweeping arrangements, in particular when cash sweeps were reversed out the following day. In this regard, one respondent pointed out that it would be important to understand whether the entity was contractually obliged to reverse the sweep or whether it did so as a result of business practice.

26. A number of respondents highlighted the importance of understanding the unit of account to which the offsetting requirements were being applied; ie an entity must establish whether it is dealing with multiple financial instruments or a single financial instrument. Consequently, within the context of cash pooling arrangements it is important to establish whether all the entities have their own legally separate account with the bank or whether only one entity is the legal counterparty and all the other entities hold sub-accounts.

Relevant accounting requirements

27. Prior to setting out our staff analysis of this issue, we outline below the relevant accounting requirements that we will use in analysing this issue.

28. Paragraph 42 of IAS 32 sets out the circumstances under which an entity is required to offset a financial asset and a financial liability in the statement of financial position [emphasis added]:

> **42** A **financial asset** and a **financial liability** shall be offset and the net amount presented in the statement of financial position when, and only when, an entity:
>
> (a) currently has a legally enforceable right **to set off the recognised amounts**; and
>
> (b) **intends either to settle on a net basis**, or to realise the asset and settle the liability simultaneously.
>
> In accounting for a transfer of a financial asset that does not qualify for derecognition, the entity shall not offset the transferred asset and the associated liability (see IFRS 9, paragraph 3.2.22).

29. Paragraph 43 of IAS 32 goes on to explain that the net presentation of the financial asset and financial liability should reflect the entity's expected future cash flows from settling those instruments [emphasis added]:

> **43** This Standard requires the presentation of financial assets and financial liabilities on a net basis **when doing so reflects an entity's expected future cash flows from settling two or more separate financial instruments**. When an entity has the right to receive or pay a single net amount and intends to do so, it has, in effect, only a single financial asset or financial liability. In other circumstances, financial assets and financial liabilities are presented separately from each other consistently with their characteristics as resources or obligations of the entity. An entity shall disclose the information required in paragraphs 13B–13E of IFRS 7 for recognised financial instruments that are within the scope of paragraph 13A of IFRS 7.

30. A right of set-off is further described in paragraph 45 of IAS 32 as follows:

> **45** A right of set-off is a debtor's legal right, by contract or otherwise, to settle or otherwise eliminate all or a portion of an amount due to a creditor by applying against that amount an amount due from the creditor.

31. Paragraph 46 notes that while the existence of an enforceable right to set off may affect the entity's exposure to credit and liquidity risk, it is only when this is combined with an intention to exercise that legal right that net presentation more appropriately reflects the amounts and timings of the expected future cash flows [emphasis added]:

> **46** The existence of an **enforceable right to set off a financial asset and a financial liability affects the rights**

> **and obligations associated with a financial asset and a financial liability and may affect an entity's exposure to credit and liquidity risk.** However, **the existence of the right, by itself, is not a sufficient basis for offsetting.** In the absence of an intention to exercise the right or to settle simultaneously, the amount and timing of an entity's future cash flows are not affected. **When an entity intends to exercise the right or to settle simultaneously, presentation of the asset and liability on a net basis reflects more appropriately the amounts and timing of the expected future cash flows, as well as the risks to which those cash flows are exposed.** An intention by one or both parties to settle on a net basis without the legal right to do so is not sufficient to justify offsetting because the rights and obligations associated with the individual financial asset and financial liability remain unaltered.

32. In terms of assessing an entity's intentions, paragraph 47 of IAS 32 provides some additional guidance, noting that consideration should be given to normal business practices and to circumstances that could limit an entity's ability to settle net [emphasis added]:

> **47** An entity's intentions with respect to settlement of particular assets and liabilities **may be influenced by its normal business practices, the requirements of the financial markets and other circumstances that may limit the ability to settle net** or to settle simultaneously. When an entity has a right of set-off, but does not intend to settle net or to realise the asset and settle the liability simultaneously, the effect of the right on the entity's credit

risk exposure is disclosed in accordance with paragraph 36 of IFRS 7.

33. The guidance above is consistent with the principles set out in paragraphs 32 and 33 of IAS 1 [emphasis added]:

> **32** An entity **shall not offset assets and liabilities** or income and expenses, unless required or permitted by an IFRS.
>
> **33** An entity reports separately both assets and liabilities, and income and expenses. Offsetting in the statement(s) of profit or loss and other comprehensive income or financial position, **except when offsetting reflects the substance of the transaction** or other event, detracts from the ability of users both to understand the transactions, other events and conditions that have occurred and to assess the entity's future cash flows […..]

34. Paragraph 11of IAS 32 sets out the definition of a financial asset and a financial liability:

> A financial asset is any asset that is:
>
> (a) cash;
>
> (b) a contractual right:
>
> (i) to receive cash or another financial asset from another entity; or
>
> [….]
>
> A financial liability is any liability that is:
>
> (a) a contractual obligation:

(i) to deliver cash or another financial asset to another entity; or

[…..]

Staff analysis

35. We note from the outreach feedback that there are many different types of cash pooling arrangements. However, the analysis that follows considers the specific type of notional cash pooling arrangement as described by the submitter.

36. As noted in paragraph 7 and for the avoidance of doubt, the specific features of the arrangement that we will analyse in this paper are as follows:

    (a) a number of subsidiaries within a group (the group) each have a legally separate account with a bank (the bank), some of which will have a positive cash balances whereas others will have a negative (overdraft) balance;

    (b) interest is calculated on the net balance of all the separate bank accounts;

    (c) there are regular transfers of balances into a single netting account instigated by the group. However:

        (i) this is not required under the terms of the arrangement;

        (ii) this is not done at the reporting date; and

        (iii) the amounts that will be set off in the future are not necessarily known at the reporting date, because the balances at the reporting date may subsequently change as group entities place further cash on deposit or withdraw cash to settle other obligations; and

(d) the bank and the group (as constituted by all legal parties to the arrangement within the group) have the necessary legally enforceable right to set these balances off at the reporting date.

37. Based on the above fact pattern, our analysis assumes that:

    (a) there are multiple legally separate bank accounts held by each of the subsidiaries within the group—each of which represents separate financial instruments and separate units of account and the group wishes to apply the offsetting requirements to the entire period-end balances at the reporting date; and

    (b) the requirements of paragraph 42(a) of IAS 32 regarding the currently enforceable legal right to set off are met.

38. In addition, the analysis considers the appropriate accounting treatment from the perspective of the group rather than of the bank.

39. In order to analyse this issue we consider the following points:

    (a) the circumstances under which net presentation is considered to be appropriate; and

    (b) whether the regular transfer of balances into a netting account (but not at the reporting date) is sufficient to demonstrate an intention to settle net.

When is net presentation appropriate?

40. In accordance with paragraph 42 of IAS 32, an entity is required to offset a financial asset and a financial liability in the statement of financial position when the entity currently has a legally enforceable right to set off the recognised amounts **and** intends either to settle on a net basis, or to realise the asset and settle

the liability simultaneously. As noted by paragraph 43 of IAS 32, when these two criteria are met, the entity has, in effect, only a single financial asset or financial liability and consequently net presentation reflects an entity's expected future cash flows.

41. Considering this guidance within the context of the example presented, we note that:

    (a) there are multiple legally separate bank accounts held by individual subsidiaries. Some subsidiaries will have deposited cash with the bank and some others will have borrowed cash from the bank. Consequently, and in accordance with paragraph 11 of IAS 32, the positive and negative bank account balances meet the definition of a financial asset and financial liability respectively and are within the scope of the offsetting requirements of IAS 32; and

    (b) the group currently has a legally enforceable right to set off the individual bank accounts' balances and therefore the requirements of paragraph 42(a) of IAS 32 are met.

42. Consequently, the remaining analysis focusses on whether the entity has an intention to settle the entire period-end balances on a net basis in accordance with paragraph 42(b) of IAS 32. Specifically, the issue is whether the regular transfer of balances (but not at the reporting date) into a netting account is sufficient to demonstrate an intention to settle on a net basis.

Is the regular transfer of balances (but not at the reporting date) into a netting account sufficient to demonstrate an intention to settle on a net basis?

43. In considering this question, we refer to the additional guidance set out in paragraphs 46 and 47 of IAS 32:

(a) paragraph 46 explains the importance of demonstrating an intention to settle net and notes that while the existence of an enforceable right to set off may affect the entity's exposure to credit and liquidity risk, it is only when this is combined with an intention to exercise that legal right that net presentation more appropriately reflects the amounts and timings of the expected future cash flows; and

(b) paragraph 47 of IAS 32 points out that in assessing whether there is an intention to net settle, an entity should consider normal business practices, the requirements of the financial markets and other circumstances that may limit the ability to settle net.

44. Consequently, when assessing whether an entity can demonstrate an intention to settle on a net basis, an entity should consider whether the net presentation of the asset and liability balances would appropriately reflect the amounts and timings of the expected future cash flows, taking into account the entity's normal business practice, the requirements of the financial markets and other circumstances that may limit the ability to settle net. In our view, this assessment will require judgement and will depend on the individual facts and circumstances pertaining to the specific case.

45. For example, we think that if individual subsidiaries within the group are expected to use their bank accounts on a day-to-day basis to meet their regular business needs in such a way that the entity expects the period-end balances to change prior to the next net settlement date, it would not be possible assert that there was an intention to settle the specific period-end balances on a net basis. In this regard, we note that one of the features of the example presented is that the entity does not necessarily know the amounts that will be offset, because the balances at the reporting date may subsequently change as group entities place further cash on deposit or withdraw cash to settle other obligations. Consequently, in our view, it

would seem difficult for the entity to assert that the intention was to settle the entire period end balances on a net basis under these circumstances because the net presentation of these balances would not seem to appropriately reflect the amounts and timings of the expected future cash flows, taking into account the entity's normal business practice.

46. However, we acknowledge that in other circumstances an entity may be able to demonstrate an intention to settle on a net basis; for example, if subsidiaries within the group used their bank accounts less frequently and balances remained static for periods of time, with the result that the entity expects that the period-end balances will be settled net at the next net settlement date.

47. Consequently, within the context of the example presented by the submitter, we consider that the entity would need to apply its judgement in order to assess whether it expects that individual account balances at the period end will be settled on a net basis, or whether it expects that those balances will be used for other purposes by various subsidiaries within the group prior to the next net settlement date.

Conclusion

48. On the basis of the analysis set out in paragraphs 35-47, we are of the view that whether the regular transfers of balances (but not at the reporting date) into a netting account would be sufficient to demonstrate an intention to settle on a net basis would depend on the individual facts and circumstances of each case and would require judgement.

49. However, when making that assessment an entity should be mindful of the guidance set out in paragraphs 46 and 47 of IAS 32. Specifically, an entity should consider whether net presentation of the asset and liability balances would

appropriately reflect the amounts and timings of the expected future cash flows, taking into account the entity's normal business practice, the requirements of the financial markets and other circumstances that may limit the ability to settle net.

50. Consequently, within the context of the example presented by the submitter, we consider that the entity would need to apply its judgement in order to assess whether it expects that account balances at the period end will be settled on a net basis or whether it expects that those balances will be used for other purposes by various subsidiaries within the group. In this regard, given that one of the features of the example presented is that the entity does not necessarily know the specific amounts that will be offset because the balances at the reporting date may subsequently change as group entities place further cash on deposit or withdraw cash to settle other obligations, we think it would seem difficult for the entity to assert an intention to settle the entire period end balances on a net basis.

Assessment against the Interpretations Committee's agenda criteria

51. We have assessed this issue against the agenda criteria of the current *Due Process Handbook*:

Paragraph 5.16 states that the Interpretations Committee should address issues:	Agenda criteria satisfied?
that have widespread effect and have, or are expected to have, a material effect on those affected;	In total we received 14 responses and a number of IFASS members and Securities Regulators commented that they had not received many views from their constituents. While a number of respondents noted that cash pooling arrangements were common, it was not clear whether the specific type of notional cash pooling arrangement described by the submitter was common. Consequently it is difficult to conclude that the issue has a widespread effect.
where financial reporting would be improved through the elimination, or reduction, of diverse reporting methods; and	Some diversity in practice was observed but this is partly driven by the many and varied types of cash pooling arrangements, as noted above. Having analysed the issue, we consider that there is sufficient guidance within existing IFRSs to determine the appropriate accounting treatment. Consequently, we think that this matter could be resolved by way of an agenda decision that sets out the staff analysis.

Paragraph 5.16 states that the Interpretations Committee should address issues:	Agenda criteria satisfied?
that can be resolved efficiently within the confines of existing IFRSs and the *Conceptual Framework for Financial Reporting*.	See above—could be resolved by way of an agenda decision.
In addition:	
Can the Interpretations Committee address this issue in an efficient manner (paragraph 5.17)?	See above—could be resolved by way of an agenda decision.
The solution developed should be effective for a reasonable time period. (paragraph 5.21)	See above—could be resolved by way of an agenda decision.

Staff recommendation

52. We note that we received a limited response to our outreach activities and while the results of the outreach indicated that the practice of cash pooling was common, it was not clear whether the specific type of notional cash pooling arrangement described by the submitter was common. Consequently, it is difficult to conclude that this issue is widespread.

53. Similarly, while divergent views on the appropriate accounting treatment were observed, it is again difficult to conclude that those divergent views related to the specific type of notional cash pooling arrangement described by the submitter.

54. Furthermore, as set out in our analysis of this issue in paragraphs 35-47, we consider that there is sufficient guidance within existing IFRSs to determine the appropriate accounting treatment. Consequently, we do not think that the Interpretations Committee's agenda criteria are met and we recommend that the Interpretations Committee should not take this issue onto its agenda.

Questions for the Interpretations Committee

Questions for the Interpretations Committee
1. Does the Interpretations Committee agree with the staff's recommendation as set out in paragraphs 52-54? 2. Does the Interpretations Committee agree with the proposed wording for the tentative agenda decision set out in Appendix A?

Appendix A—Proposed wording for tentative agenda decision

B1. We propose the following wording for the tentative agenda decision:

IAS 32—offsetting and cash pooling

The IFRS Interpretations Committee (‘the Interpretations Committee’) has received a request to address an issue related to IAS 32 *Financial Instruments: Presentation.*

The issue relates to whether certain cash pooling arrangements would meet the requirements for offsetting under IAS 32—specifically, whether the regular transfers of balances (but not at the reporting date) into a netting account would be sufficient to demonstrate an intention to settle the entire period-end account balances on a net basis in accordance with paragraph 42(b) of IAS 32.

For the purposes of the analysis, the Interpretations Committee considered a notional cash pooling arrangement between a number of subsidiaries within a group, each of which have legally separate bank accounts, each of which in turn represents separate units of account. Both the bank and the group have the necessary legally enforceable right to set off balances in these bank accounts in accordance with paragraph 42(a) of IAS 32. Interest is calculated on the net balance of all the separate bank accounts and the group instigates regular transfers of balances into a single netting account. However, such transfers are not required under the terms of the arrangement and are not done at the reporting date. Furthermore, the specific amounts that are to be set off in the future are not necessarily known at the reporting date because those balances may subsequently change as group entities place further cash on deposit or withdraw cash to settle other obligations.

In considering whether the group could demonstrate an intention to settle on a net basis in accordance with paragraph 42(b) of IAS 32, the Interpretations Committee observed that:

(a) as highlighted in paragraph 46 of IAS 32, the requirement to demonstrate an intention to settle net is equally as important as having a legally enforceable right to set off, because it is only when there is an intention to exercise that that legal right, that net presentation more appropriately reflects the amounts and timings of the expected future cash flows; and

(b) in accordance with paragraph 47 of IAS 32, when assessing whether there is an intention to net settle, an entity should consider normal business practices, the requirements of the financial markets and other circumstances that may limit the ability to settle net.

Consequently, within the context of cash pooling arrangements such as that described by the submitter, the Interpretations Committee noted that an entity should consider the guidance above and that judgement would be required in order to assess whether, at the reporting date, there is an intention to set off individual account balances or whether the intention is that those individual account balances would be used for other purposes by various entities within the group. In this regard, the Interpretations Committee observed that in the example presented the specific amounts that are to be set off in the future are not necessarily known at the reporting date. It would therefore seem difficult for the entity to assert that it had the intention to settle the entire period-end balances on a net basis because presenting these balances net would not seem to appropriately reflect the amounts

and timings of the expected future cash flows, taking into account the entity's normal business practice.

The Interpretations Committee also observed that the results of the outreach did not suggest that this issue was widespread. Furthermore, it was noted that many different variations of cash pooling arrangements existed in practice and consequently the determination of what constitutes an intention to settle on a net basis would depend on the individual facts and circumstances of each case. In the light of this and given the existing IFRS requirements, the Interpretations Committee considered that neither an amendment to IAS 32 nor an interpretation was necessary and consequently [decided] not to add the issue to its agenda.

Appendix B—Original submission received

B1. We reproduce below the submission that we received. We have deleted details that would identify the submitter of this request.

Suggested agenda item: Offsetting under IAS 32 Financial Instruments: Presentation

It has come to our attention that there are divergent views on the appropriate treatment of the offsetting requirements under IAS 32 Financial Instruments: Presentation for certain cash pooling arrangements. We are seeking clarification of the issue detailed below by the Committee.

Under paragraph 42 of IAS 32, a financial asset and a financial liability shall be offset and the net amount presented in the statement of financial position when, and only when, an entity:

(a) currently has a legally enforceable right to set off the recognised amounts; and
(b) intends either to settle on a net basis, or to realise the asset and settle the liability simultaneously.

Example of a cash pooling arrangement
Each of a number of entities within a group has a legally separate bank account with Bank B. At any time, some of these accounts have a positive cash balance and others have a negative (overdraft) balance. For cash management purposes, the group operates a notional pooling arrangement.

Under this arrangement, Bank B calculates the net balance on the designated accounts with interest being earned or paid on the net amount. There are regular transfers of balances into a single (`netting') account, but this is not done at the reporting date. The regular transfers are not required under the terms of the arrangement but are instigated by the group to replace bank account balances of various group entities with

intercompany balances with a single entity within the group holding the netting account with the bank. The amounts that will be set off at future regular intervals are not necessarily known at the reporting date because the balances at the reporting date may subsequently change as group entities place further cash on deposit or withdraw cash to settle other obligations.

Under the arrangement both Bank B and the group (as constituted by all legal parties to the arrangement within the group) have the necessary legal enforceable right to set these balances off under IAS 32 at the reporting date.

Issue

Are the regular, but not at the reporting date, transfers of balances into a netting account sufficient to demonstrate an intention to settle on a net basis for the purposes of meeting the requirement in IAS 32:42(b)?

Alternative views

Yes

Proponents of this view believe that when there is regular net cash settlement of the accounts the requirements of IAS 32:42(b) are met and net presentation for the group is appropriate at the reporting date. The fact that there is no certainty that the actual cash balances and overdrafts outstanding at the reporting date will be offset through subsequent transfer into the netting account does not change this view, as long as the group can clearly demonstrate the intention to settle the accounts net through a regular practice of net settlement.

No

Proponents of this view believe that a regular practice of net settlement is not sufficient to meet the offsetting requirements in IAS 32:42(b). To meet the criterion of Intend[ing] to settle on a net basis, there must be an intention at the reporting date to net settle the specific balances outstanding at that date. The positive cash balances (asset balances) will rise and fall as the group's subsidiaries place further cash on deposit or withdraw cash to settle other obligations. Although the positive cash balances at the reporting date

could be used to settle any negative cash balances (liability balances), the group cannot claim offset because it does not have the intention at the reporting date to settle the negative cash balances with the positive cash balances. Rather, the group's intention is to use the positive cash balances at the reporting date, and potentially draw down more borrowings if needed to support subsidiaries' working capital needs.

Reasons for the Committee to address the issue

Notional cash pooling arrangements, as described above, are relatively common and as such clarity on this issue is needed as diversity in practice exists. Currently, divergent views can be demonstrated to exist as each of the two views above is expressed in the published literature of two of the large accounting firms.

In addition, the issue is not related to a Board project that is expected to be completed in the near future.

For these reasons, we believe that this issue meets the criteria for acceptance onto the Committee's agenda.