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Accounting & Tax Committee
Japan Foreign Trade Council, Inc.

To the International Accounting Standards Board

Comments on "Offsetting Financial Assets and Financial Liabilities"

The following are the comments of the Accounting & Tax Committee of the Japan Foreign Trade Council, Inc. (JFTC) made in response to the solicitation of comments regarding the International Accounting Standards Board Exposure Draft "Offsetting Financial Assets and Financial Liabilities" (hereinafter ED). The JFTC is a trade-industry association with trading companies and trading organizations as its core members, while the principal function of its Accounting & Tax Committee is to respond to developments in domestic and international accounting standards. (Member companies of the Accounting & Tax Committee of JFTC are listed at the end of this document.)

I. General Comments

Regarding the theme of "Offsetting Financial Assets and Financial Liabilities," we note that the current IFRS and US GAAP standards provide for significantly different accounting methods. These differences generate major disparities in financial statements, to the extent that they seriously undermine comparability, particularly in the case of financial institutions. From this perspective, we highly appreciate the IASB and FASB joint proposal and the pursuit of convergence.

However, we note that the proposal requires mandatory offsetting for all financial instruments, including trade receivables and trade payables, when the criteria have been met. We expect that this will give rise to various difficulties in actual practice, and therefore request that provisions stipulating other options to allow offsetting be developed.

II. Specific Issues (Comments on Questions)

Question 1
Question 2

We do not agree.

The proposal requires offsetting for all financial instruments, including trade receivables and trade payables, when the criteria have been met. We are concerned that mandatory offsetting will give rise to various difficulties in actual practice. For this reason, we request that provisions stipulating other options to allow offsetting be developed. Entities can be naturally expected to avoid increasing their total assets without reason. Therefore, we do not think that allowing for other options would generate significant problems in comparability.

- We oppose application to derivative assets and liabilities.

  There are cases in derivatives transactions where a multiple number of selling and purchasing transactions in the same market, but with differing maturities, are managed as a single bundle of transactions. For transactions subject to this type of practice, instead of reflecting expected future cash flow based on the asset/liabilities framework, we believe that the risk exposure the entity has in mind would be more appropriately reflected by allowing net presentation, even if settlement is not simultaneous. Therefore, we believe that the exceptions related to derivative assets and liabilities that exist in the current US GAAP should be included.

- We are opposed to the prohibition on offsetting of collateral and the associated financial assets and financial liabilities (paragraph 9). When cash is tendered as a security deposit for derivatives transactions, even if this constitutes "collateral" for legal purposes, it may be set off not only in the case of default but also in routine settlement of derivatives transactions. In such cases, the economic substance of the security deposit is exactly the same as a prepayment in fund settlement for a derivatives transaction. As long as the criteria of paragraph 6 are met, net presentation should be allowed regardless of whether or not the cash deposit constitutes collateral, and it is unreasonable to prohibit offsetting merely on the grounds that the deposit is legally viewed to be collateral. Paragraph BC62 contains the following statement. "The boards note that users are interested in information about an entity's performance and financial position rather than simply credit risk." Particularly in the case of cash collateral, it is normal for entities to manage their financial position and their performance after offsetting of collateral. For this reason, net presentation probably more accurately reflects the reality of the entity.

Question 4

We do not agree with paragraphs 12–15.

Problems in comparability of financial statements arising from differences in the current IFRS and US GAAP are mainly related to the derivatives transactions of financial institutions. An expansion in the

scope of disclosure requiring all entities to disclose all information related to offsetting would be excessively burdensome. On the other hand, the benefits to investors are not large enough to justify the cost. While we support the concept of additional disclosure contained in paragraph 11, we request that due consideration be given to the preparers of financial statements, such as by limiting the scope of disclosure to qualitative explanations of the details of offset pertinent to corporate activity and the gross amounts before offset.

- It would be going too far to require, as stipulated in paragraph 12(c)–(e), disclosure of financial assets and financial liabilities that are not set off because they do not meet the criteria . Moreover, we do not find any necessity in requiring this disclosure. The offsetting proposals contained in this ED would have limited impact on the financial statements of nonfinancial entities. However, a conditional right to set off as mentioned under paragraph 12(d) is included in many basic agreements and contracts with counterparties and financial institutions (e.g., inclusion of the following in sales contracts: forfeiture of the benefit of time in case of counterparty's default and establishment of the right to set off when the intent to set off has been previously declared). Moreover, in industries supplying many types of products and services in very large quantities and engaging in transactions with large numbers of counterparties, it becomes very difficult to determine the existence of a conditional right to set off on a case-by-case basis. For the above reasons, the aggregations indicated under paragraph 12(c)–(e) would frequently prove difficult in actual practice.
- The submission or acceptance of margin and other financial instrument collateral mentioned in paragraph 12(f)–(g) can be a common and frequent occurrence for nonfinancial entities also. Regarding the scope of disclosure, we believe that sufficient information can be obtained from disclosure under the following provisions of IFRS 7: paragraph 14, which requires disclosure of the carrying amount and fair value of collateral submitted; and paragraph 15, which mandates disclosure of the fair value and terms of agreement concerning collateral held (restricted to cases in which an entity holds collateral and is permitted to sell or repledge the collateral in the absence of default by the owner of the collateral). Thus, we believe that it would be going too far to require disclosure of the fair value of all collateral being held.

Question 5

(a)

We do not agree.

We believe that a rule should be established for first-time adoption. As in the case of derecognition, entities undergoing first-time adoption should be allowed to apply this standard solely to transactions taking place on and after the transition date.

(b)

Two years.

To comply with the disclosure requirements proposed in the ED, it will be necessary to confirm the requirements for determining whether the financial assets and financial liabilities for the period in question can be set off. This task will require an enormous amount of effort. Consequently, preparation will require a considerable amount of time.

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