

April 28, 2011

Technical Director Financial Accounting Standards Board 401 Merritt 7, P.O. Box 5116 Norwalk, CT 06856-5116

File Reference No. 2011-100

The Accounting Principles Committee of the Illinois CPA Society (Committee) appreciates the opportunity to provide its perspective on the Proposed Accounting Standards Update: *Balance Sheet (Topic 210) – Offsetting*. The Committee is a voluntary group of CPAs from public practice, industry and education. Our comments represent the collective views of the Committee members and not the individual view of the members or the organizations with which they are affiliated. The organization and operating procedures of our Committee are outlined in Appendix A to this letter.

Our committee generally supports the offsetting of certain assets and liabilities in the presentation of the balance sheet. However, we believe the proposal's requirement that an entity must *intend* to settle assets and liabilities through offsetting or simultaneous liquidation is overly restrictive in that it leaves on the balance sheet assets and liabilities for which the entity has no economic exposure.

Our committee supports the objective of improving comparability. Therefore, we favor a single standard within U.S. GAAP rather than the industry-specific practices and exceptions that now exist. We also support convergence with IFRS. However, our concerns about this proposal would apply equally to its adoption by the IASB, and we would not support its adoption by the FASB for the sake of convergence alone.

Our responses to the specific questions posed in the Exposure Draft follow.

Question 1: The proposals would require an entity to offset a recognized eligible asset and a recognized eligible liability when the entity has an unconditional and legally enforceable right to setoff the eligible asset and eligible liability and intends either:

- 1. To settle the eligible asset and eligible liability on a net basis
- 2. To realize the eligible asset and settle the eligible liability simultaneously.

Do you agree with this proposed requirement? If not, why? What criteria would you propose instead and why?

Legally Enforceable Right

We agree with the requirement that a legally enforceable right to setoff must exist for assets and liabilities to be eligible for offsetting. As discussed in our response to Question 2, we do not believe such a right needs to be unconditional.

Intent

We disagree with the requirement that an entity must intend to settle the asset and liability on a net basis or simultaneously. We concur with the argument at BC54 that when the right to setoff exists, there is a single asset and liability, regardless of how the asset and liability will be realized and settled at some future date. When a right to setoff exists, an entity has no economic exposure to either the asset or the liability individually, but only an exposure to the net position. At some later date, if either the asset is realized or the liability is settled, but not both, then the entity will be exposed to the other. But until that time, there is no such exposure.

We believe a problem with the use of intent as a criterion for offsetting is that the concept of intent cannot be considered independent from the circumstances the reporting entity faces when it is time to realize assets and settle liabilities. That is, the reporting entity may not care *in general* whether settlement is done on a gross or net basis or whether it is done simultaneously or at different points in time. It will care about how settlement occurs if the counter-party is in financial distress and in that case it will take all the steps necessary to preserve its right to offset assets and liabilities so as to minimize its potential losses. The reporting entity's intent to settle net *in the circumstances where doing otherwise would result in losses* is all that is required to convert an asset and a liability into a net asset or net liability position. It is only the reporting entity's intent when losses are at stake that matters.

We also concur with the argument at BC54 that intent is "subjective and difficult to substantiate." We further note that the intent criterion is subject to abuse, allowing the reporting entity to state an intent, one way or the other, merely to get a particular accounting treatment. As a result, two entities in identical economic positions could present very different balance sheets due merely to an assertion.

BC56 argues that without an intent to settle on a net basis or simultaneously, the right to offset has no effect on the amount or timing of future cash flows. We find it difficult to believe that investors' cash flow forecasts will be substantially different depending on this presentation. The Boards' conclusion that in the absence of an intent to settle net, investors' cash flow forecasts will be more reliable if the balance sheet is presented without netting is based on an unsupported premise. We believe the more important issue is investors' perceptions about exposure to assets and liabilities. In that respect, offsetting when there is a legally enforceable right to do so, regardless of intent, is the more faithfully representational approach.

Finally, some of our committee members are concerned about the auditability of intent. It would be difficult for an auditor to establish independent evidence either to support or to contradict management's assertions.

The Meaning of Simultaneous Settlement

As discussed above, we oppose the inclusion of the intent criterion. However, if it remains in the standard, then we believe the Boards need to consider more carefully the meaning of "simultaneous settlement." At C11, the proposed guidance states "...if settlements take place over a period (even though during this period there is no potential for any change in the value of the eligible asset and eligible liability and the period between settlements of the instruments is brief), it is not simultaneous settlement because settlement is not at the same time." Many constituents are likely to interpret this guidance to require a level of precision with respect to the timing of payment transfers that is operationally impossible to achieve. Also, it is unclear whether this guidance intends for initiation or completion of settlement to be simultaneous. We recommend that the Boards provide additional clarification on the assessment of the simultaneous settlement criterion in its application guidance.

Question 2: Under the proposals, eligible assets and eligible liabilities must be offset if, and only if, they are subject to an unconditional and legally enforceable right of setoff. The proposals specify that an unconditional and legally enforceable right of setoff is enforceable in all circumstances (that is, it is enforceable in the normal course of business and on the default, insolvency, or bankruptcy of a counterparty) and its exercisability is not contingent on a future event. Do you agree with this proposed requirement? If not, why? What would you propose instead and why?

We agree with the requirement that a legally enforceable right of setoff must exist for there to be offsetting of assets and liabilities. Without such a right, the reporting entity retains separate exposures to the underlying assets and liabilities. We do not believe, however, that such a right needs to be unconditional. As long as the right to setoff exists in the circumstances under which a reporting entity's economic position would be affected by its existence and the right survives bankruptcy, then the asset and liability should be presented on a net basis. In such circumstances, the reporting entity has no economic exposure to the other party's asset because in the event of a default, the right to offset would be available.

Question 3: The proposals would require offsetting for both bilateral and multilateral setoff arrangements that meet the offsetting criteria. Do you agree that the offsetting criteria should be applied to both bilateral and multilateral setoff arrangements? If not, why? What would you propose instead, and why? What are some of the common situations in which a multilateral right of setoff may be present?

We agree that the proposal should apply equally to bilateral and multilateral arrangements. The same underlying purpose of the standard is served when the proposal is applied to multilateral arrangements as when it is applied to bilateral arrangements.

Question 4: Do you agree with the proposed disclosure requirements in paragraphs 11–15? If not, why? How would you propose to amend those requirements and why?

If the purpose of this proposal is that in circumstances where there is only a net asset or a net liability the reporting entity should report only its net position, then it is difficult to see the incremental information that would be provided by the gross amounts. Absent a clear explanation of how these amounts add value, we see no reason to require their disclosure.

Question 5: Do you agree with the proposed transition requirements in Appendix A? If not, why? How would you propose to amend those requirements and why? Please provide an estimate of how long an entity would reasonably require to implement the proposed requirements.

We believe the effective date should be at least one year after the proposal is adopted. Because we do not believe adoption would be overly difficult, we do not believe the effective date needs to be different for private entities.

While we agree that retrospective application is appropriate, we believe it is operational only if, as we have suggested, the intent criterion is removed from the proposal. If the intent criterion remains, then retrospective application is problematic for two reasons. First, it may be difficult to ascertain what management's intent was at an earlier date. There likely would be no records on which accountants could rely to establish what the intent was at the time. Second, if the intent criterion remains, retrospective application raises the issue of whether an entity may deem that it had the intent to settle on a net basis at a prior balance sheet date when it subsequently did not do so. Similarly, should an entity be able to deem that it did not intend to settle on a net basis at the time, when it subsequently did settle in that manner? These two problems suggest the Boards need to address whether, in applying the standard retrospectively, reporting entities should ignore intent and report the assets and liabilities either gross or net, depending on the manner in which they were actually settled.

We appreciate the opportunity to offer our comments.

Sincerely,

Jeffery P. Watson, CPAChair, Accounting Principles Committee

Scott G. Lehman, CPAVice-chair, Accounting Principles Committee

APPENDIX A ACCOUNTING PRINCIPLES COMMITTEE ORGANIZATION AND OPERATING PROCEDURES 2011-2012

The Accounting Principles Committee of the Illinois CPA Society (Committee) is composed of the following technically qualified, experienced members appointed from industry, education and public accounting. These members have Committee service ranging from newly appointed to more than 20 years. The Committee is an appointed senior technical committee of the Society and has been delegated the authority to issue written positions representing the Society on matters regarding the setting of accounting standards. The Committee's comments reflect solely the views of the Committee, and do not purport to represent the views of their business affiliations.

The Committee usually operates by assigning Subcommittees of its members to study and discuss fully exposure documents proposing additions to or revisions of accounting standards. The Subcommittee ordinarily develops a proposed response that is considered, discussed and voted on by the full Committee. Support by the full Committee then results in the issuance of a formal response, which at times, includes a minority viewpoint. Current members of the Committee and their business affiliations are as follows:

Public Accounting Firms:

Large: (national & regional) Ryan Brady, CPA

> John A. Hepp, CPA Alvin W. Herbert, Jr., CPA

Daniel J. Hoffenkamp, CPA Scott G. Lehman, CPA

Elizabeth A. Prossnitz, CPA Robert B. Sledge, CPA Reva B. Steinberg, CPA

Jeffery P. Watson, CPA **Medium:** (more than 40 professionals)

Brian T. Kot. CPA

Jennifer L. Williamson, CPA **Small:** (less than 40 professionals)

Barbara Dennison, CPA Kathleen A. Musial, CPA

Michael D. Pakter, CPA

Industry:

Rose Cammarata, CPA Farah Hollenbeck, CPA James B. Lindsey, CPA Marianne T. Lorenz, CPA Michael J. Maffei, CPA Jacob R. Mrugacz, CPA Ralph Nach, CPA

Anthony Peters, CPA
Amanda M. Rzepka, CPA

Educators:

James L. Fuehrmeyer, Jr. CPA Laine E. Malmquist, CPA Leonard C. Soffer, CPA

Staff Representative:

Gayle S. Floresca, CPA

Grant Thornton LLP Grant Thornton LLP

Retired, Clifton Gunderson LLP

Ernst & Young LLP Crowe Horwath LLP BDO USA LLP KPMG LLP

Retired, BDO USA LLP Blackman Kallick LLP

Cray Kaiser Ltd CPAs

Ostrow Reisen Berk & Abrams Ltd.

Selden Fox, Ltd. BIK & Co, LLP

Gould & Pakter Associates LLC

CME Group Inc. Hospira, Inc. TTX Company Nicor Inc.

GATX Corporation

U.S. Cellular Telephone & Data Systems

SkillSmart LLC

McDonald's Corporation

JSSI

University of Notre Dame Judson University University of Chicago

Illinois CPA Society