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International Accounting Standards Board
30 Cannon Street
London EC4M 6XH
United Kingdom

Comments on the Exposure Draft, *Offsetting Financial Assets and Financial Liabilities*

To the Board Members:

The Japanese Institute of Certified Public Accountants (“we” and “our”) appreciates the continued efforts of the International Accounting Standard Board (IASB) on the financial crisis, and welcomes the opportunity to comment on the Exposure Draft (ED) on *Offsetting Financial Assets and Financial Liabilities*.

Question 1 - Offsetting criteria: unconditional right and intention to settle net or simultaneously

The proposals would require an entity to offset a recognised financial asset and a recognised financial liability when the entity has an unconditional and legally enforceable right to set off the financial asset and financial liability and intends either:

- (a) to settle the financial asset and financial liability on a net basis or
- (b) to realise the financial asset and settle the financial liability simultaneously.

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

Comment:

We agree with the proposals.

We believe that by requiring an entity to offset financial assets and financial liabilities under certain conditions, rather than by making this set-off optional, the ED will help the users of financial statements gain access to useful information. A condition that allows an entity to offset unconditionally when it intends to do so will be essential in enabling the entity to claim that the net amount resulting from the offset represents, in effect, a single financial asset or liability.

And in order to present the net financial asset or net financial liability resulting from the set-off as a single financial asset or financial liability, cash inflow and outflow should also represent a single asset or single liability. For this reason, we believe that it is appropriate to require the entity to settle the financial asset or financial liability either on a net basis or simultaneously. Paragraph C11 of the ED explicitly requires “simultaneous” settlement, and the paragraph precludes settlements even in different time zones or settlements that take place over a short period of time. If these settlements are permitted, then any amount that cannot be assumed to be a net settlement can be included in the set-off. Therefore, we agree to set a limit to the financial assets and financial liabilities that will be subject to set-off by specifically requiring the rule on “simultaneous” settlement.

Question 2 - Unconditional right of set-off must be enforceable in all circumstances

It is proposed that financial assets and financial liabilities must be offset if, and only if, they are subject to an unconditional and legally enforceable right of set-off. The proposals specify that an unconditional and legally enforceable right of set-off is enforceable in all circumstances (ie 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?

Comment:

We agree with the proposed requirement, however, there are some points that need to be further clarified as outlined below.

As stated in our comment on Question 1, offsetting should be required only when the net amounts resulting from set-off represents, in effect, a single financial asset or liability for the entity. We believe that the scope of the application of offsetting would expand too far if it were to include circumstances such as the insolvency or bankruptcy of a counterparty when net settlements were not conducted.

However, a provision in paragraph 9 of the ED states that, “An entity shall not offset, in

the statement of financial position, assets pledged as collateral (or the right to reclaim the collateral) or the obligation to return collateral obtained and the associated financial assets and financial liabilities.” In this regard we recommend that paragraph 9 clearly state whether or not “collateral” means assets only usable under a conditional set-off.

Question 3 - Multilateral set-off arrangements

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

Comment:

We agree with the proposals.

While we have no reason to disagree with the proposals, we cannot foresee many cases where the criteria would apply in practice.

Question 4 - Disclosures

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?

Comment:

We disagree with the proposed disclosure requirements.

Though the requirement partially includes items related to the existence of credit enhancement, the items do not meet the ED objectives specifying offsetting criteria with a focus on the singularity of the cash flow. On these grounds, we believe that items (c) to (g) of paragraph 12 should be eliminated from the requirements.

More specifically, among the disclosure requirements outlined in paragraph 12, the only items related to the arrangements that meet the offsetting criteria are items (a) and (b). On the other hand, items (c), (d), and (f) require disclosure of information related to certain credit enhancements that do not meet the offsetting criteria under this ED. Also, the net amount calculated by considering the effect of all items from (a) to (f), as outlined in item (g) of the paragraph 12, is disclosed as the “net exposure” in item (viii) of example 1. Therefore, this amount is calculated simply by accounting for a certain part of the credit enhancement and does not show the net exposure that reflects the entire credit risk of the relevant entity. If the purpose of the disclosure is to disclose the changes that the set-off would have on the entity’s financial position, we believe that

merely requiring an entity to disclose the rights of the set-off and related arrangements that meet the offset criteria would be sufficient in this standard, and that information related to credit enhancement should be dealt with in IFRS 7 *Financial Instruments: Disclosure*, a standard that requires disclosure of credit risks.

Question 5 - Effective date and transition

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

Comment:

We agree with the proposed transition requirements. Retrospective application for all comparative periods presented would be helpful for the users of financial statements from the perspective of comparability.

Yours faithfully,

Keiko Kishigami

Executive Board Member – Accounting Practice (IFRS)

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