



KPMG IFRG Limited
8 Salisbury Square
London EC4Y 8BB
United Kingdom

Tel +44 (0)20 7694 8871
Fax +44 (0)20 7694 8429
mary.tokar@kpmgifrg.com

Sir David Tweedie
International Accounting Standards Board
1st Floor
30 Cannon Street
London
EC4M 6XH

Our ref MT/288
Contact Mary Tokar

Technical Director
File Reference No. 2011-100
Financial Accounting Standards Board
401 Merritt 7, PO Box 5116
Norwalk, CT 06856-5116
United States of America

28 April 2011

Dear Sir David and Technical Director,

Comment letter on:

- **Exposure Draft ED/2011/1 *Offsetting Financial Assets and Financial Liabilities***
- **Exposure Draft Proposed Accounting Standards Update *Balance Sheet (Topic 210) Offsetting***

We appreciate the opportunity to comment on the joint proposals included in the International Accounting Standards Board's (IASB) Exposure Draft ED/2011/1 *Offsetting Financial Assets and Financial Liabilities* and the Financial Accounting Standards Board's (FASB) Exposure Draft Proposed Accounting Standards Update *Balance Sheet (Topic 210) Offsetting* (together, the ED). This letter expresses the views of the International network of KPMG member firms, including KPMG LLP (US). This letter is being submitted to the IASB and the FASB for sharing and joint consideration.

We support the objective of the IASB and the FASB (together, the Boards) to establish a common principle for offsetting financial assets and financial liabilities because we believe that convergence between IFRSs and US GAAP is an important objective for financial instruments accounting.



KPMG IFRG Limited
Comment letter
28 April 2011

We support the proposed offsetting criteria in principle. However, we believe there are a number of ambiguities and inconsistencies in the proposed guidance. In order to avoid inappropriate interpretation and inconsistent application of the criteria, we believe that there should be consistency between the proposed offsetting criteria, defined concepts and related application guidance. Also, the Boards should make efforts to understand and signpost more clearly the changes in practice from IAS 32 *Financial Instruments: Presentation* (IAS 32) that they intend to effect. In particular, there will be significant challenges in applying the proposals to complex settlement and credit support arrangements with clearing houses or between financial market counterparties. These arrangements cover enormous transaction volumes and values and improving the proposed guidance in this area will be crucial to fostering consistent application. We recommend that the Boards undertake further outreach activities with clearing houses and financial institutions so that the Boards fully understand typical arrangements and application challenges and can ensure that the final application guidance delivers clarity in this area. In contrast to the ED, the Boards should make clear that offsetting of derivative and cash margin balances would be required when the proposed offsetting criteria are met.

We believe that proposed disclosure requirements in the ED are excessive and would involve costs disproportionate to the benefits they provide. Given that the ED proposes that offsetting is appropriate only when there is in effect a single financial asset or liability, we believe that disclosure of pre-offsetting gross amounts adds little benefit. The other disclosure requirements seem intended to provide information about exposure to credit risk and how it is managed. We believe that relevant useful elements should be integrated with the existing requirements of IFRS 7 *Financial Instruments: Disclosures* (IFRS 7) and FASB ASC Topics 815, *Derivatives and Hedging* and 825, *Financial Instruments* (ASC Topics 815 and 825) and duplications eliminated.

As noted in our comment letter on the Boards' Request for Views / Discussion Paper *Effective Dates and Transition Methods*, there is a significant interaction between international and national regulatory capital requirements for financial institutions and changes to IFRS and US GAAP financial reporting that may be relevant in setting effective dates for the financial reporting changes. We agree with the Boards' view that the objective of financial reporting for investors is different from that of prudential regulation and that, as a result, their offsetting or netting requirements may be different. Although the requirements of Basel II and III with respect to netting of certain repurchase agreements and derivatives and related collateral may be unaffected by the proposals in the ED, some financial institutions may be subject to different or additional national capital adequacy requirements based on offsetting in their financial statements (e.g. banks in the United States). US GAAP currently allows entities to offset certain repurchase agreements and derivatives and related collateral where the right to set off is conditional and there is no intention to set off in the normal course of business. The ED proposes to preclude the offsetting of such arrangements under US GAAP. This proposed change to US GAAP may give rise to a need for some financial institutions, absent a change in relevant regulatory capital requirements, to raise significant amounts of fresh equity capital even



KPMG IFRG Limited
Comment letter
28 April 2011

though their underlying economic exposures have not changed. We therefore recommend that the Boards work together with prudential regulators to identify any such significant dependencies between regulatory capital and financial reporting offsetting requirements and ensure that the effective date of the new financial reporting offsetting requirements is established so as to allow adequate time to resolve any such issues before adoption becomes mandatory.

Appendix 1 to this letter contains our responses to the specific questions asked by the Boards while Appendix 2 includes more detailed comments on particular application and drafting issues.

Please contact Mary Tokar or Chris Spall +44 (0)20 7694 8871 or Enrique Tejerina at +1 (212) 909-5530 if you wish to discuss any of the issues raised in this letter.

Yours sincerely

KPMG IFRG Limited

KPMG IFRG Limited



KPMG IFRG Limited
Comment letter
28 April 2011

Appendix 1

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?

We agree in principle with the proposed offsetting criteria. The proposed criteria would establish principles that are consistent with the *Framework for the Preparation and Presentation of Financial Statements*, IAS 1 *Presentation of Financial Statements* and FASB Statement of Financial Accounting Concepts No. 1, *Objectives of Financial Reporting by Business Enterprises*. They are designed to convey useful information about the rights and obligations and expected cash flows associated with financial assets and financial liabilities which is based both on their substantive contractual features and an entity's approach to managing the resulting cash flow requirements. Furthermore, the proposed criteria are intended to be similar to the current criteria in IAS 32 that have worked reasonably well in practice.

However, we believe there are a number of ambiguities and inconsistencies in the proposed guidance. In order to avoid inappropriate interpretation and inconsistent application of the criteria, we believe that there should be consistency between the proposed offsetting criteria, defined concepts and related application guidance. Also, the Boards should make efforts to understand and signpost more clearly the changes in practice from IAS 32 that they intend to effect. In particular, there will be significant challenges in applying the proposals to complex settlement and credit support arrangements with clearing houses or between financial market counterparties. These arrangements cover enormous transaction volumes and values and improving the proposed guidance in this area will be crucial to fostering consistent application. We recommend that the Boards undertake further outreach activities with clearing houses and financial institutions so that the Boards fully understand typical arrangements and application challenges and can ensure that the final application guidance delivers clarity in this area. We include more detailed comments on these matters in Appendix 2 to this letter.

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



KPMG IFRG Limited
Comment letter
28 April 2011

an unconditional and legally enforceable right of set-off is enforceable in all circumstances (i.e. 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 in principle with the proposed requirement that offsetting of financial assets and financial liabilities is not permitted unless they are subject to an unconditional and legally enforceable right of set-off that is enforceable in all circumstances. This criterion would ensure that a financial asset and a financial liability are offset only if the entity has in substance a right to or obligation for the net amount, i.e. the entity has in effect a single net financial asset or liability.

We suggest the Boards clarify in the final standard that the requirement for enforceability on the insolvency of a counterparty extends to enforceability on insolvency or bankruptcy of the (reporting) entity.

See also our detailed comments in Appendix 2.

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?

We agree that the offsetting criteria should be applied to both bilateral and multilateral set-off arrangements. We see no conceptual reason to preclude application of the proposed offsetting criteria to multilateral set-off arrangements since, if the proposed criteria are met, then the objective described in paragraph 4 of the ED also would be satisfied.

The most common situations of which we are aware in which explicit contractual rights of set-off between more than two parties are present involve group banking arrangements. However, we believe that such arrangements are unlikely to qualify for offsetting under the proposed criteria as, irrespective of other factors, there is not usually an intention to settle net. It is common for multiple entities within a group to have deposit and overdraft or other borrowing arrangements with a bank that are together subject to a right of set-off. Similarly a single entity may have deposit and borrowing arrangements with different legal entities within the same banking group. Similar arrangements might exist in other scenarios involving related parties.

Additionally, we note that the meanings of the terms 'bilateral' and 'multilateral' are not clear without further definition or explanation for the purpose of application to arrangements that involve related parties. In some cases a set-off arrangement may cover multiple legal entities that might together be considered part of a single consolidated reporting entity for accounting



KPMG IFRG Limited
Comment letter
28 April 2011

purposes. Also, laws in some jurisdictions might combine the estates of multiple entities for insolvency purposes or allow a right of set-off between multiple parties on the basis that two or more are considered substantially the same person. Any prohibitions on or special requirements for offsetting of multilateral rights of set-off would require a clear definition of their scope and add unnecessary complexity to the standard.

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?

We do not agree with the proposed disclosure requirements in paragraphs 11-15. We believe that the proposed disclosure requirements are excessive and that an independent disclosure objective about rights of set-off is not worthwhile.

We understand that the Boards obtained responses from users that both gross and net information is useful for analysing financial statements. However, we do not believe that this general preference justifies the detailed disclosures proposed, especially in the context of the narrow circumstances in which offsetting would be permitted and the other information that entities already are required to disclose under IFRS 7 in respect of credit risk and liquidity risk and ASC Topics 815 and 825 in respect of credit risk.

The proposed tabular disclosures in paragraph 12 would require disclosure of reconciliations by class of asset and liability of gross pre-offsetting amounts to post-offsetting balance sheet amounts. We believe that carrying amounts presented in the statement of financial position, based on the proposed offsetting criteria, present the most useful information. The proposed offsetting criteria are narrowly defined and allow offsetting only when an entity has, in effect, a single asset or liability and the carrying amounts represent these rights and obligations and the expected cash flows associated with an entity's financial assets and financial liabilities. We therefore believe that additional information on the gross amounts adds little value relative to the costs associated with disclosure.

Paragraph 12 also would require reconciliations by class of asset and liability of post-offsetting balance sheet amounts to a 'net amount' after taking account of rights of set-off that do not qualify for offsetting and collateral. The ED does not describe what the 'net amount' is intended to represent or the specific purpose beyond noting in paragraphs BC76 and 77 that rights of set-off and collateral arrangements that do not qualify for offsetting may reduce counterparty credit risk exposures. We agree that such rights and arrangements may reduce credit risk and liquidity risk. IFRS 7 already requires disclosure of qualitative and quantitative information about credit risk and liquidity risk arising from financial instruments and how an entity manages its exposures to those risks. ASC Topics 815 and 825 have similar requirements for credit risk. We therefore recommend that relevant and useful elements of the proposed disclosure requirements for rights of set-off and collateral arrangements that do not qualify for



KPMG IFRG Limited
Comment letter
28 April 2011

offsetting should be integrated with the existing requirements of IFRS 7 and ASC Topics 815 and 825 and any duplicative requirements should be eliminated.

In improving the proposals for disclosure, we recommend that the Boards also consider the following points:

- Requiring separate tabular disclosures by class may require disclosure of an enormous volume of information by some financial institutions and may even be confusing as amounts are offset between different classes.
- Paragraph 12(d) would require the possible effects of all conditional rights of set-off to be captured. This may require extensive data mining and capture by many financial institutions to produce information that may have little practical relevance and is disconnected from how the institution manages credit risk. For example, in some jurisdictions, there is a general right of set-off available to mutual debtors and creditors in the case of insolvency. The ED would require, for example, a bank to capture and match outstanding balances on all products (e.g. current accounts, savings accounts, personal loans, mortgages) with individual retail customers for the purposes of this disclosure. However, in many cases, the institution would not consider the net amount to be reflective of its credit risk exposure since unless and until a customer defaults on a loan or mortgage, it has no legal or practical ability to set off and a customer is likely to withdraw any deposits prior to that time. We recommend that conditional rights of set-off should be subject to quantitative disclosure requirements only to the extent that they are relevant to the entity's management of credit or liquidity risk arising from the relevant assets and liabilities.
- The disclosures in paragraph 12(d) would be required separately for each type of conditional right of set-off while paragraphs 13 and C17 would require separate descriptions of each type of conditional right of set-off along with the criteria applied in aggregating similar types of right. Especially in the context of the discussion in the previous paragraph and given the many different types of rights that may be available in different jurisdictions, this suggests a volume and level of detail that appears excessive.

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?

We agree with the proposal for retrospective application for all comparative periods presented, except for the effect of portfolio-level fair value adjustments for credit risk. Portfolio-level fair value adjustments for credit risk are part of the IASB's *Fair Value Measurement* standard and amendments to FASB ASC Topic 820 *Fair Value Measurements and Disclosures* (ASC Topic 820) that are currently under development and which are both expected to be applicable prospectively. Therefore, we suggest that any requirements in respect of portfolio-level fair



KPMG IFRG Limited
Comment letter
28 April 2011

value adjustments should be applicable prospectively only from the date that an entity adopts the IASB's new *Fair Value Measurement* standard or the amended ASC Topic 820.

(b) Please provide an estimate of how long an entity would reasonably require to implement the proposed requirements.

The time reasonably required for an entity to implement the proposed requirements would depend greatly on the circumstances of the entity, in particular the volume and complexity of the arrangements which would be impacted by the ED's proposals in relation to both presentation and disclosure. The most significant impact is likely to be for banks and similar financial institutions. The effect also may vary depending on whether the entity currently reports under IFRS or US GAAP and how it has applied relevant existing presentation and disclosure requirements. In order to apply the proposals, an entity needs to evaluate the terms of relevant financial instruments, including settlement and margin arrangements, and their legal effect. Whether an entity's right of set-off would meet the legally enforceable criterion depends on the law governing the contract and the bankruptcy regime that governs the insolvency of the entity and its counterparties. Therefore, further input from legal specialists may be necessary to understand whether the offset criteria would be met. The extensive proposed disclosure requirements also may require significant investigation and changes to underlying data systems in order to capture the possible effects of conditional rights of set-off that entities do not currently track or use for the purposes of either financial reporting or risk management (see our response to Question 4). Other systems changes may also be necessary to track the gross amounts of financial assets and financial liabilities that qualify for offsetting and align systems with the other proposed disclosure requirements.

We encourage the Boards to ensure that they obtain sufficient feedback from preparers, in particular large financial institutions, to ensure that they have adequate information as to the time reasonably required for implementation.

Notwithstanding the detailed matters above, we note that the ED is an integral part of the Boards' projects to replace their standards on financial instruments accounting. As well as dealing with changes proposed in the ED, preparers will also have to manage the implementation of multiple interacting other changes resulting from other elements of the same project, as well as changes resulting from the other major projects that the Boards are undertaking (e.g. revenue recognition, leasing, insurance contracts).

We therefore recommend that the Boards synchronise the effective date of new requirements on offsetting with the effective date of other elements of their new standards on financial instruments accounting in order to reduce the burden on reporting entities related to sequential implementation.

In our comment letter on the Boards' Request for Views / Discussion Paper *Effective Dates and Transition Methods* (RfV/DP), we suggested a single effective date for all chapters of IFRS 9 *Financial Instruments* of periods starting on or after 1 January 2015. Please see that comment



KPMG IFRG Limited
Comment letter
28 April 2011

letter for other detailed comments on factors that the Boards should consider in establishing effective dates in the context of the major accounting changes planned during 2011 and subsequently.

As noted in that comment letter, there is a significant interaction between international and national regulatory capital requirements for financial institutions and changes to IFRS and US GAAP financial reporting that may be relevant in setting effective dates for the financial reporting changes. We agree with the Boards' view that the objective of financial reporting for investors is different from that of prudential regulation and that, as a result, their offsetting or netting requirements may be different. Although the requirements of Basel II and III with respect to netting of certain repurchase agreements and derivatives and related collateral may be unaffected by the proposals in the ED, some financial institutions may be subject to different or additional national capital adequacy requirements based on offsetting in their financial statements (e.g. banks in the United States). US GAAP currently allows entities to offset certain repurchase agreements and derivatives and related collateral where the right to set off is conditional and there is no intention to set off in the normal course of business. The ED proposes to preclude the offsetting of such arrangements under US GAAP. This proposed change to US GAAP may give rise to a need for some financial institutions, absent a change in relevant regulatory capital requirements, to raise significant amounts of fresh equity capital even though their underlying economic exposures have not changed. We therefore recommend that the Boards work together with prudential regulators to identify any such significant dependencies between regulatory capital and financial reporting offsetting requirements and ensure that the effective date of the new financial reporting offsetting requirements is established so as to allow adequate time to resolve any such issues before adoption becomes mandatory.

We also request that the Boards clarify whether early adoption of the new requirements on offsetting is permitted. The ED is silent on this matter. In our comment letter on the IASB Exposure Draft ED/2010/13 *Hedge Accounting*, we suggested that early adoption of IFRS 9 and a new standard on insurance contracts should be permitted only if both standards are adopted in their entirety and together. This suggestion does not apply to entities in jurisdictions that have already adopted final standards related to the IAS 39 replacement project.



KPMG IFRG Limited
Comment letter
28 April 2011

Appendix 2

In addition to our answers to the specific questions raised in the ED, we have the following comments related to the consistency between the proposed criteria, the defined concepts and the application guidance and areas where we believe the ED is not sufficiently clear as to how the proposals should be applied and the extent of intended changes in practice from IAS 32. We believe that the Boards should provide clarification to ensure consistent interpretation and application.

Application of the ‘unconditional’ concept to derivatives and other financial instruments with uncertain cash flows

Derivatives sometimes are described as ‘conditional contracts’ in the sense that the future cash flows depend on future changes in an underlying. Therefore, the ability of an entity to exercise a right of set-off under a derivative contract, even if it is not conditional on any other event, might be argued to be conditional on there actually being future amounts payable and receivable that can be set-off.

Although there are references in the Basis for Conclusions to the ED to the gross presentation of derivative assets and liabilities generally providing more relevant and better information about cash flows and exposure to risk, the only explicit statements as to the failure of derivative assets and liabilities to qualify for offsetting is in the context of master netting agreements in which the right to off-set is conditional on default or termination. Therefore, we suggest that the Boards clarify how the ‘unconditional’ requirement applies to derivatives and other financial instruments with uncertain cash flows.

Effect of automatic netting arrangements

Extent of offset

Under some master netting agreements, all cash payments and receipts due on the same day in the same currency may be unconditionally subject to set-off. Paragraph C9 indicates that such an arrangement demonstrates the entity’s intention to settle on a net basis.

However, the ED does not explain whether that intention is demonstrated only if, or to the extent that, cash flows are due on the same day in the same currency, or if it extends to the entirety of financial instruments subject to the agreement. If there are some cash flows under the financial instruments that are in different currencies or are due on different days, then those cash flows would not (absent default) in practice be set off. Financial instruments subject to such arrangements may involve multiple payments on different dates, some of which coincide and some of which do not.

A similar issue arises with respect to paragraph C9’s reference to rules of clearing houses that provide for automatic netting and cancellation of offsetting contracts. Given the complexity of



KPMG IFRG Limited
Comment letter
28 April 2011

these issues, which is compounded by the fact that these agreements may cover many hundreds of contracts with cash flows spreading out many years into the future, we urge the Boards to clarify whether such agreements or rules that provide for automatic set-off of payments that occur on the same day and in the same currency satisfy the intention to settle on a net basis at the level of:

- all financial instruments under the same arrangement;
- only financial instruments whose entire cash flows coincide exactly with (i.e. due on the same day and in the same currency) and are set off by another financial instrument subject to the same arrangement; or
- specific cash flows of financial instruments that are due on the same day in the same currency.

We note that requiring partial offset of financial assets and liabilities based on coincidence of specific cash flows would be operationally complex and would require guidance as to how the carrying amounts of financial assets and liabilities would be attributed between the specific underlying cash flows.

Batch processing

Although the requirements of clearing houses may establish an unconditional right of set-off in relation to all cash payments and receipts due on the same day in the same currency, we understand that, for operational reasons, in practice some clearing houses settle such transactions in two or more batches during the course of each working day. We also understand that several entities have considered such arrangements to qualify for offsetting under IAS 32.

Paragraph C12 of the ED indicates that transactions that are settled gross qualify for offsetting only if settlement is simultaneous while paragraph C8 indicates that systems that do not facilitate net settlement for operational reasons do not qualify for offsetting, unless simultaneous settlement is intended. However, as noted above, paragraph C9 states that agreements that provide for automatic set-off of payments due on the same day in the same currency establish an intention to settle net.

The interaction of these paragraphs is not clear. Given the large volume and value of transactions that are potentially affected by this issue, we recommend that the Boards clearly address how they intend such batch processing arrangements to be treated.

Cash collateral and margin

It is not entirely clear whether and, if so, why the ED's proposal to prohibit offsetting of assets pledged as collateral or the obligation to return collateral extends to all cash margin



KPMG IFRG Limited
Comment letter
28 April 2011

arrangements. Paragraph BC 63 states that the Boards concluded that cash collateral should not be offset against recognised payables and receivables.

This may be read to indicate that the prohibition is intended only to apply to cash collateral that does not meet the proposed general offsetting criteria. Additionally the Boards' intent may be to reserve the term 'collateral' to amounts that are used for settlement only in the event of default. However, cash margin accounts may in certain cases operate as cash deposit accounts with or from the counterparty that are used in the normal course of events to settle payments or receipts under derivatives or other transactions within the scope of the same master agreement. In these cases, there is a right of set-off between the amount receivable (or payable) in respect of the deposit against the amount payable (or receivable) in respect of the financial instrument to which it relates, and there is an intention to settle net.

An example of an arrangement that combines many of the issues raised above with respect to derivatives, master agreements, cash margin and automatic netting, may be an entity that is a member of a clearing house. Transactions entered into with other members of the clearing house are novated such that the clearing house is the legal counterparty to the entity for all those transactions. Cash margin is payable or receivable between the entity and the clearing house based on the fair value of outstanding transactions. Only one net cash payment or receipt, which covers final settlement of maturing transactions, periodic payments on existing transactions and net payment or receipt of cash margin, occurs each day between the entity and the clearing house. This net settlement mechanism is part of the contractual terms and is considered to be legally enforceable. Given the large volume and value of financial instruments transacted under similar arrangements with clearing houses, the treatment of such transactions will be a significant application issue for many entities. The significance will likely increase as prudential regulators encourage or require the transition of more transactions to centralised clearing houses and if similar arrangements are increasingly used in over-the-counter business. Therefore, the Boards should clarify whether and, if so, why the ED's proposal to prohibit offsetting of assets pledged as collateral or the obligation to return collateral extends to all cash margin arrangements.

Enforceability on insolvency or bankruptcy of the (reporting) entity

The requirement of legal enforceability extends to all circumstances and this is specifically mentioned as including insolvency or bankruptcy of one of the counterparties (paragraph 10(e)), as opposed to insolvency or bankruptcy of the counterparty with whom the entity transacts. Therefore, it appears that offsetting is precluded unless the right of set-off is enforceable even in the event of the entity's own insolvency or bankruptcy. This reading is supported by an example included in the 'Snapshot' prepared by staff of the IASB, which was published at the same time as the ED. We suggest that the Boards state explicitly in the final standard that a legally enforceable right of set-off requires enforceability in insolvency or bankruptcy of the (reporting) entity.



KPMG IFRG Limited
Comment letter
28 April 2011

Right of set-off that expires on a specific date

Paragraph C15 states that a right of set-off that is exercisable only before a specific date is not considered to be unconditional and does not qualify for offsetting. The ED does not explain why this is the case or how it is consistent with the defined concept of an unconditional right of set-off. The reasoning behind the proposed guidance may be that occurrence of the date on which the right expires is considered an event and that its exercisability is contingent on that date not occurring. However, we believe that it is unusual to consider the passage of time to be either an event or contingent.

It is possible that the guidance is intended to capture only situations in which the entity may not be able to exercise the right of set-off in practice because the right of set-off is only capable of exercise at the time of settlement, but the right of set-off expires before the scheduled settlement date or expires if settlement is delayed.

However, in other cases, a right of set-off, i.e. to apply the amount due to another entity as a reduction in the due from that other entity, might be freely and immediately exercisable prior to the actual or scheduled settlement date. In these cases, the only condition that would preclude exercisability or enforceability is the reporting entity failing to exercise the right.

Therefore, we recommend that the Boards clarify why and to what extent a right of set-off expiring on a specific date fails to qualify as unconditional or enforceable.

Right of set-off that is exercisable upon termination of a contract

Based on paragraph C4, a right of set-off that is exercisable upon termination of a contract appears to be identified as an example of a conditional right of set-off that does not qualify for offsetting.

In many cases, termination of the contract may be contingent on an event that is outside the entity's control, e.g. the counterparty's default or bankruptcy. In this case the right of set-off is clearly conditional. However, in some cases, termination of a contract may be a free choice of the entity and is therefore within the entity's control. Also, the act of termination may merely be the means by which net settlement is achieved (for example, an arrangement between a bank and a customer whereby termination of a loan or a related restricted deposit requires simultaneous or net settlement of both).

It is not discussed in the proposals whether events that are within the entity's control are considered contingent on the occurrence of a future event. We recommend that the Boards clarify whether such rights of set-off are considered conditional or unconditional rights of set-off.



KPMG IFRG Limited
Comment letter
28 April 2011

Portfolio-level adjustments

The ED discusses the disclosure of portfolio-level adjustments for credit risk but does not mention portfolio-level adjustments for market risk. We understand that the Boards are planning to permit adjustments of both types in the IASB's forthcoming new *Fair Value Measurement* standard and the FASB's related amendments to ASC Topic 820 that are expected to be issued soon. We recommend that the content of the final standard on offsetting with respect to portfolio-level adjustments should be updated to be consistent with the new fair value measurement guidance.

Scope - IFRS

Paragraph 3 of the IASB's ED states that the proposals would apply to all items within the scope of IAS 39 *Financial Instruments: Recognition and Measurement* (IAS 39). However, the current offsetting requirements are included in IAS 32 and therefore apply to all financial instruments within the scope of IAS 32. Financial assets and liabilities that represent rights and obligations under leases, to which IAS 17 *Leases* (IAS 17) applies, are within the scope of IAS 32 but generally are scoped out of IAS 39. Therefore we recommend that the IASB consider whether it is appropriate that the proposed offsetting requirements would not apply to financial assets and liabilities that represent rights and obligations under IAS 17.

Scope - US GAAP

The paragraph 'Scope and Scope Exceptions' in Appendix D of the FASB's ED states that the guidance in this Subtopic does not modify the accounting treatment in the particular circumstances prescribed by, amongst others, paragraphs 840-30-35-32 through 35-52 (leveraged leases) and Subtopic 740-30 (net tax asset or liability amounts reported).

Paragraphs 840-30-35-32 through 35-52 (leveraged leases) contain guidance on income recognition on leveraged leases. Therefore we recommend that the FASB consider whether these references should be to paragraphs 840-30-25-8, 9 and 840-30-30-14 that address the presentation in the statement of financial position of leveraged leases.

Subtopic 740-30 (net tax asset or liability amounts reported) contains guidance on other considerations or special areas related to income taxes. Therefore we recommend that the FASB consider whether this reference should be to the paragraphs in section 740-10-45 that address presentation matters related to income taxes.

Other Presentation Matters – US GAAP

We recommend that the FASB clarify why 940-320-45-2 is superseded by the proposed accounting standards update. This paragraph pertains to the line-item presentation of proprietary securities transactions and we are unclear as to why the proposed offsetting standard impacts this guidance.