Please note that the comments expressed herein are solely my personal views

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15 March 2011

- Your Ref: Comment letter on Exposure Draft ED/2011/1
- Offsetting Financial Assets and Financial Liabilities

Dear Sir,

Thank you for giving us the opportunity to comment on your exposure draft ED/2011/1: Offsetting Financial Assets and Financial Liabilities.

I support your joint proposals, which should lead to more comparability between entities reporting under IFRSs and US Gaap, and also between entities reporting under the same regime. The proposals should also bring more transparency to bear in the presentation of financial statements, and any supporting information provided, particularly given the clear definition of offsetting and extensive disclosures thereon.

Rationale behind the proposed definition of offsetting

It is interesting to refer to IAS 1, Presentation of Financial Statements, in order to determine the intended purpose of financial statements. Paragraph 9 states that:

   Financial statements are a structured representation of the financial position and financial performance of an entity. The objective of financial statements is to provide information about the financial position, financial performance and cash flows of an entity that is useful to a wide range of users in making economic decisions. Financial statements also show the results of the management’s stewardship of the resources entrusted to it. To meet this objective, financial statements provide information about an entity’s:
   (a) assets;
   (b) liabilities;
   ……
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This sounds reasonable. The reference to providing information about assets and liabilities suggests that offsetting should not be allowed for separate financial assets and financial liabilities as this would reduce the amount of information available for users of financial statements (users). However, a common sense principle would be that if separate financial assets and financial liabilities interact in such a way that they are, in effect, equivalent to a single net amount in all circumstances, then allowing offsetting and reporting this net amount would result in very little information being lost to users. If this common sense principle was accompanied by sufficient disclosure of gross and net amounts, then arguably no information would be lost to users.

For this common sense principle to hold, we would have to require that such offsetting results in a single net amount that replicates the interaction of the financial asset and the financial liability in all circumstances. Therefore I support the proposed definition of offsetting, which is based on the definition in IAS 32, but which is more complete, requiring an "unconditional and legally enforceable right to set off the financial asset and financial liability", rather than just "currently has a legally enforceable right to set off the recognised amounts".

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1 See IAS 32, paragraph 42.
Answers to specific questions raised by the IASB

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?

Yes, I agree with this proposed requirement. In order to offset a financial asset and a financial liability we must require that the interaction of the asset and liability can be replicated by the resulting net amount in all circumstances. This ensures that there is no significant loss of information for users compared with gross reporting.

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?

Yes, the unconditional right of set-off must be enforceable in all circumstances, otherwise net reporting could lead to a significant loss of information to users. Please also see my response to question 1.

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?

Yes, I agree that the offsetting criteria should be applied to both bilateral and multilateral set-off arrangements. I agree with paragraph C13, and with your argument in paragraph BC61,
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that there is "no basis for explicitly excluding multilateral netting arrangements from the scope of offsetting if all the other criteria, including legal enforceability, are met for the transaction".

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?

Yes, I agree with the proposed disclosure requirements in paragraphs 11–15. These are complete and would be sufficient to provide more meaningful information to users. I also agree that it is important to disclose information about rights of set-off, irrespective of whether the proposed offsetting criteria are satisfied, and collateral arrangements, in order that users could understand their effects on an entity’s financial position.

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?

Yes, I agree with the proposed transition requirements in Appendix A. Prospective transition would lead to a confusing treatment of pre-transition set-offs compared with post-transition set-offs. A full retrospective application in accordance with IAS 8 would provide more comparable and useful information to users.

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

I would expect that some greater systems effort would be needed to produce the proposed disclosures, and particularly concerning tracking the gross and net financial assets and financial liabilities required here. I only add that I would expect there to be more effort involved in the transition for entity’s that currently report under US Gaap compared with entity’s that report under IFRSs, given the greater disparity in existing offsetting treatment under US Gaap compared with existing IFRSs and this joint proposal.

Yours faithfully

C.R. Barnard

Chris Barnard