Dear Ms. Cosper,


We are writing on behalf of the International Corporate Governance Network (ICGN). The ICGN is a global membership organisation of over 500 institutional and private investors, corporations and advisors from 50 countries. Our investor members are responsible for global assets of U.S. $12 trillion.

The ICGN’s mission is to raise standards of corporate governance worldwide. In doing so, the ICGN encourages cross-border dialogue at conferences and influences corporate governance public policy through its Committees. We promote best practice guidance, encourage leadership development and keep our members informed on emerging issues in corporate governance through publications and the ICGN website. Information about the ICGN, its members, and its activities is available on our website: www.icgn.org.

The purpose of the Accounting and Auditing Practices Committee (A&A Practices Committee) is to address and comment on accounting and auditing practices from an international investor and shareholder perspective. The Committee through collective comment and engagement strives to ensure the quality and integrity of financial reporting around the world. http://www.icgn.org/policy_committees/accounting-and-auditing-practices-committee/

Thank you for the opportunity to comment on the Exposure Draft on Offsetting Financial Assets and Financial Liabilities, File Reference No. 2011-100. We support the Boards’ joint issuance of this exposure draft (ED) to address differences in the offsetting requirements in U.S. Generally Accepted Accounting Principles (GAAP) and International Financial Reporting Standards (IFRS). Currently, financial statements prepared under IFRS or GAAP cause significant quantitative differences within the established offsetting accounting standards. We believe current practices in the U.S. do not provide full disclosure of a company’s total exposure and agree this ED would provide additional information to investors. In our view, netting of assets and liabilities on the balance sheet obscures the amount of leverage a company may have taken on and the amount of risk that it is exposed to.

We support this specific guidance and agree that entities should not offset assets and liabilities unless specifically required or permitted. ICGN is strongly in favour of harmonization of netting rules; currently analysts must make netting assumptions when comparing GAAP and IFRS reporting entities. We also believe
that netting rules are more appropriate as IFRS only allows netting when there is an intention to settle net. At present, the reported financial position based on identical eligible assets and eligible liabilities can be very different under IFRS and GAAP, making comparing financial positions of entities in the same industry but reporting under either IFRS or GAAP difficult (and in some cases almost pointless).

The proposals in this ED would eliminate the exceptions under GAAP for offsetting derivatives and (reverse) repurchase agreements and would greatly improve transparency and comparability of entities using such instruments reporting under both IFRS and GAAP.

At the same time the proposals in the ED would improve the comparability of IFRS reporting entities by making the right of set-off unconditional.

ICGN continues to support convergence to a single set of high-quality global accounting standards. We believe the proposed ED will provide investors with additional transparency, comparability and improvement in the utility of financial reporting which leads to improved capital allocation decisions. We support that balance sheets would be more descriptive of firms’ rights and obligations and would increase comparability among global companies.

We support the objective of this joint project and provide a response to the outlined questions:

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?

ICGN agrees that an entity should be required to offset recognised financial and derivative assets (eligible assets) and financial and derivative liabilities (eligible liabilities) when it has an unconditional and legally enforceable right of set-off and intends either to settle the asset and liability on a net basis or to realise the asset and settle the liability simultaneously. We also strongly support the harmonization efforts of IFRS and GAAP on offsetting financial assets and financial liabilities.

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 (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?

Yes, ICGN supports that offsetting should only occur where the unconditional right of set-off is enforceable in all circumstances. ICGN also supports the specification of the conditionality of counterparty master netting agreements and collateral obtained or pledged and believes that by restricting offsetting in the financial statements a more accurate view of solvency and liquidity will be provided.
to users of financial reports. However, we recommend the project consider how this approach to ‘conditionality’ will relate to other places in IFRSs (standards and other guidance) where assessments of ‘conditionality’ are required.

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 apply whether the right of set-off arises from a bilateral arrangement or from a multilateral arrangement. We support that an entity’s recognised gross eligible assets and recognised gross eligible liabilities are presented in the statement of financial position separately according to their nature.

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, ICGN agrees with the proposed disclosure requirements in paragraphs 11-15. We believe these requirements would enhance disclosures required by GAAP and IFRS by requiring improved information about eligible assets and eligible liabilities subject to set-off and related arrangements and the effect of those arrangements on an entity’s financial position.

We support the proposed requirements to be disclosed in both annual and interim reporting (quarterly and/or semi-annually). The eligible assets and liabilities would also have to be reassessed frequently (preferably at least once per interim reporting period) in order for the financial position of the entity to reflect the adequate conditionality of set-off rights.

We further support aggregating quantitative information on offsetting into classes by eligible assets and eligible liabilities where further breakdown would not provide the users of financial disclosure with more information, provided the quantitative data is available in tabular format showing the total of eligible assets and eligible liabilities settled net for the reporting period and at least one corresponding prior period.

However we would also like the project to be assured that these disclosures will result in clearer, quality information that is considered ‘reasonable’ under a cost benefit analysis.

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.

ICGN is supportive of retrospective application and recommend the Boards consider an effective date that allows for appropriate transition and in conjunction with other key joint project effective dates. We would like to emphasize that the topic of offsetting eligible assets and eligible liabilities is very important for the convergence of IFRS and GAAP and that it would be preferable for users of financial
disclosures to have the effective date and transition phase of the proposal to be synchronized for both standards.

If you would like to discuss any of these points, please do not hesitate to contact Carl Rosén, our Executive Director, by phone +44 207 612 7098 or email carl.rosen@icgn.org. Thank you for your attention and we look forward to your response on the points above.

Yours sincerely,

Christianna Wood
Chairman of the ICGN Board of Governors

Cc: Sir David Tweedie, Chairman, IASB
    ICGN Board Members
    ICGN A&A Practices Committee