11 February 2011

International Accounting Standards Board (IASB)

Dear Sir/Madam,

Response to ED/2011/1 Offsetting Financial Assets and Financial Liabilities

- 1. I thank the IASB for the opportunity to comment on the aforementioned ED. Before I proceed to articulate my views on this ED, I would like to emphasise upfront that the comments that are expressed herein are solely my *personal views* and strictly do *not* reflect those of any organisation to which I may be associated presently and/or previously in various capacities.
- 2. From a purely technical perspective, I would say that the subject matter that this ED seeks to address is comparatively less complex than the other issues tackled under the joint project to revamp and converge financial instruments accounting under IFRSs and US GAAP. For existing IFRS reporters, this ED probably has minimal impact, as it is based fundamentally on the extant IAS 32 offsetting requirements for financial assets and financial liabilities.
- 3. However, from a strategic viewpoint, I think this ED signifies a key milestone for both the IASB and the FASB in the journey to reach a common consensus for financial instruments accounting under IFRSs and US GAAP. Specifically, what is strategically significant about this ED is that it represents both Boards' recommended convergence solution for the offsetting of financial assets and financial liabilities. Considering that both Boards continue to diverge in their thinking on how financial instruments accounting should be revamped, I see the synchronisation of both Boards' views in this ED as a good confidence-building step towards achieving convergence in a highly contentious area that has caused the global financial and regulatory communities much angst in recent times. Negotiating the path from vision to reality will not be easy. I urge the Boards to continue to work closely together to resolve the outstanding technical issues, and to realise the collective vision of a robust global accounting standard for financial instruments.

My responses to specific questions posed in the ED can be found in the Appendix to
mment letter.
faithfully,
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Appendix

Question	Comments
Question 1 - Offsetting criteria: unconditional right and	
intention to settle net or simultaneously	
The proposals would require an entity to offset a recognised financial	Commenting from the perspective of the IFRS framework, I note that
asset and a recognised financial liability when the entity has an	the offsetting criteria for financial assets and financial liabilities
unconditional and legally enforceable right to set off the financial asset	proposed in this ED are almost identical to the prevailing offsetting
and financial liability and intends either:	conditions stipulated in paragraph 42 of IAS 32, except for further
	"tightening" of the condition relating to the right of set-off [vide
(a) to settle the financial asset and financial liability on a net basis or	paragraph 6(a)]. In principle, I have no issue with the extant IAS 32
	conditions governing the offsetting of financial assets and financial
(b) to realise the financial asset and settle the financial liability	liabilities. Accordingly, I agree with the proposed offsetting
simultaneously.	requirement in this ED.
Do you agree with this proposed requirement? If not, why? What	Conceptually, I think the proposed offsetting conditions remain
criteria would you propose instead, and why?	largely consistent with the overarching principles espoused in
eriteria would you propose instead, and wily!	paragraphs 32 and 33 of IAS 1. In my view, offsetting on the face of
	the financial statements effectively entails information loss from the
	perspective of the primary users of those financial statements. It thus
	follows logically that gross reporting of assets, liabilities, income and
	expenses should constitute the norm for financial statement
	presentation. Offsetting or net reporting of assets, liabilities, income
	and expenses should be required under only limited circumstances
	where doing so would more faithfully represent the economics and

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	substance of the transaction(s) concerned.
	In this respect, I think the Boards have done the right thing in putting forward the relatively more stringent IFRS offsetting principles as the recommended convergence solution for the offsetting of financial assets and financial liabilities.
	I concur with the Boards that, in the absence of the joint circumstances of (1) an unconditional and legally enforceable right to set off and (2) the intention to either settle on a net basis or realise the financial asset and settle the financial liability simultaneously, offsetting of such transactions on the face of the financial statements does not faithfully represent the underlying economics and must thus be strictly proscribed.
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	I fully support the proposed condition that an "unconditional and legally enforceable" right of set-off must exist in order for offsetting to be required on the face of the financial statements. I note that this is a "tightening" of the current condition specified in paragraph 42(a) of IAS 32, with the intention of clarifying and emphasising the IASB's position that the right of set-off must be enforceable in all

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exercisability is not contingent on a future event. Do you agree with this	circumstances.
proposed requirement? If not, why? What would you propose instead,	
and why?	As I have mentioned in my comment to Question 1, gross reporting of assets, liabilities, income and expenses should be the norm in
	financial statement presentation because of the principle espoused in paragraph 33 of IAS 1. Offsetting is an exception that should only be
	required under limited circumstances where doing so achieves more
	faithful representation of the underlying economics of the
	transaction(s) concerned.
	Viewed from this standpoint, I think it is sound conceptually to require enforceability of the right of set-off in all circumstances as one of the mandatory pre-requisites for offsetting of financial assets and financial liabilities. Unless the right of set-off is enforceable in all circumstances, the financial asset and the financial liability concerned effectively represent separate aspects of the entity's financial position. While the former constitutes an economic resource to the entity, the latter exposes the entity to a claim against its economic resources. Because the former is not "ring-fenced" as an economic resource to settle the latter, there is no valid basis for netting the two via an offset.
	I welcome the editorial amendment that has been made to the "right
	of set-off' condition in paragraph 6(a) of the ED vis-à-vis paragraph

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	42(a) of IAS 32. In my view, the editorial amendment provides
	better clarity of the IASB's position than what is presently articulated
	in paragraph 42(a) of IAS 32.
Question 3 - Multilateral set-off arrangements	
The proposals would require offsetting for both bilateral and multilateral	I concur with the Boards that offsetting should be required for both
set-off arrangements that meet the offsetting criteria. Do you agree that	bilateral and multilateral set-off arrangements as long as the
the offsetting criteria should be applied to both bilateral and multilateral	offsetting criteria are fully satisfied. In my view, the offsetting
set-off arrangements? If not, why? What would you propose instead,	conditions should be the sole determining factor as to whether the
and why? What are some of the common situations in which a	offsetting of financial assets and financial liabilities should be
multilateral right of set-off may be present?	required on the face of the financial statements.
	From a principle-based perspective, I agree with the Boards'
	conclusion in paragraphs BC60 and BC61 that it is not conceptually
	sound to adopt a "blanket policy" stance of excluding all multilateral
	set-off arrangements from offsetting. That it is generally difficult for
	multilateral netting arrangements to fully satisfy the offsetting
	conditions in practice, does not necessarily imply that there will not
	be the rare instances where such arrangements fully satisfy the
	conditions. Furthermore, with the evolution of the legal systems in
	many jurisdictions, one cannot discount the possibility of those rare
	"offset-eligible" multilateral netting arrangements becoming the
	norm in the future. A principle-based standard should draw on

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	conceptually logical reasoning to cater for all possible scenarios in
	practice, including those so-called "unusual circumstances".
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?	I note that this ED has introduced further disclosure requirements relating to financial assets and financial liabilities that are offset as well as those where the "right of set-off" criterion is met but the management intention for net or simultaneous settlement is absent. Similar to the recent ED/2010/13 on hedge accounting, a preference for tabular format is also indicated.
	While I appreciate that financial statement users had demonstrated strong support for robust disclosures (vide paragraph BC72), I have my reservations as to whether the Boards have adequately considered the "big picture" in terms of the volume and interaction of the extensive disclosure requirements that have been proposed in the various EDs under the project to overhaul financial instruments accounting. As I see it, there is a serious risk of "disclosure creep" threatening to impose excessive preparation costs on preparers and creating "information overload" for financial statement users. As such, I strongly urge the Boards to initiate a holistic cost-benefit analysis to streamline and optimise the disclosure model for the revamped financial instruments accounting standard.

Que	estion	Cor	nments
		201 Nov urge prin Frai resu stan prin disc state Disc	ther to my earlier comment letters to ED/2010/6 dated 16 August 0, ED/2010/9 dated 16 September 2010, ED/2010/8 dated 6 vember 2010 and ED/2010/13 dated 27 January 2011, I further the the IASB to consider adopting a more holistic approach to ciple-based disclosures through the development of a Disclosure mework. The present absence of a Disclosure Framework has alted in the IFRS disclosure requirements being developed on a dard-by-standard basis, without reference to a unifying set of ciples espousing disclosure objectives and the extent to which closures should support the numbers reported in the financial ements. I hope to see the IASB including a project to develop a closure Framework for Financial Reporting in its future technical anda.
Que	estion 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?	(a)	Viewed from both the conceptual and strategic angles, I would say that the proposed retrospective transition approach is superior to the alternative prospective approach.
(b)	Please provide an estimate of how long an entity would reasonably require to implement the proposed requirements.		Conceptually, a retrospective transition approach is the best way to achieve longitudinal comparability of financial information, and is consistent with the retrospective application principle

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	espoused in IAS 8 under the IFRS framework.
	For IFRS reporters, I do not see much implementation issues with a retrospective transition approach, considering that the proposals in this ED are almost identical to the extant IAS 32 offsetting provisions. For many IFRS reporters, I suspect that the transition would be virtually a non-event. For US GAAP reporters, albeit the change is envisaged to be more material in terms of the number changes in the statement of financial position (SFP), I do not foresee the change management effort to be seriously "off-limits" from a cost-benefit perspective.
	Strategically, I would also think that the Boards' objective of attaining global comparability between the IFRS and US GAAP SFP would be more impactfully served through a retrospective transition approach than a prospective transition approach. A retrospective transition approach would be more impactful because this would best ensure comparability between the SFP prepared under IFRSs and US GAAP on both the longitudinal (i.e. inter-period) and cross-sectional (i.e. inter-entity) dimensions.
	On the foregoing basis, I support the Boards' proposed retrospective transition approach.

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	(b) In my capacity as an independent commentator, it would not be appropriate for me to comment on implementation timelines. However, as I anticipate that the proposals in this ED are likely to have an asymmetrically heavier impact on US GAAP reporters than IFRS reporters, I would advise the Boards to give greater weight to the feedback received from US GAAP reporters in finalising the effective date for this ED.