

Comments of the Institute of Chartered Accountants of India on Exposure Draft on ‘Offsetting Financial Assets and Financial Liabilities’

Being a member of Asia Oceanic Standards Setters Group (AOSSG) our following comments are the same as that of the AOSSG with a few exceptions:

1 Principles for offsetting criteria (Questions 1 and 2)

- 1.1 We support the principles of offsetting financial assets and financial liabilities as being proposed in ED, subject to the comments in the subsequent paragraphs.

Unconditional and legally enforceable right to offset

- 1.2 The application of the requirement relating to ‘unconditional’ in ED needs to be examined in comparison to other Standards, for example, paragraph 69(d) of IAS 1 *Presentation of Financial Statements*, which states that “an entity shall classify a liability as current when... it does not have an ‘unconditional’ right to defer settlement of the liability for at least twelve months after the reporting period...”. In particular, in practice the ‘unconditional’ criterion in paragraph 69(d) of IAS 1 is applied in a going concern context. The IASB’s proposed clarification of the meaning of unconditional in this ED, which includes assessing conditionality in the context of bankruptcy or insolvency, calls into question how that term should be interpreted in other IFRSs. If the ‘unconditional’ requirement were applied in the proposed context under IAS 1, all liabilities would most likely be classified as ‘current’. Accordingly, IASB should clarify its intention in proposing the guidance relating to ‘unconditional right’, and how that relates to other Standards with a similar notion.
- 1.3 In addition, if the proposed requirement for a right to set off to be unconditional and legally enforceable in all circumstances, including at times of bankruptcy or insolvency, is included in IFRS 9 *Financial Instruments*, this notion should be incorporated in the principles of the Standard and not in the guidance.
- 1.4 The requirement for reassessment of the right of set off when conditions have changed should be incorporated in the principles of the Standard and not in the guidance.

Settlement on a net basis or simultaneously

- 1.5 Paragraph C11 of ED states that “Realization of a financial asset and settlement of a financial liability are simultaneous only if settlements take place at the same moment...”. It is also noted that paragraphs C9 and C12 clarify that, in the case of centrally cleared financial markets, an entity’s intention to settle net or simultaneously is considered to have been demonstrated at the date of entering into the contracts. There also appears to be inconsistency between ED and paragraph 48 of IAS 32, whereby simultaneous settlement is deemed to occur through the operation of a clearing house. This aspect needs clarification on the lines of paragraph 48 of IAS 32.

Offsetting of cash collateral against underlying derivative financial instruments

- 1.6 ED states that an entity shall not offset financial assets, including cash, pledged as collateral or the obligation to return collateral and the associated financial assets and financial liabilities. This proposal may impact the treatment of cash margin accounts related to derivative contracts, for example, over the counter transactions. Under the proposals, such margin accounts are described as a form of collateral for the counterparty

or clearing house. However, in effect, cash collateral operates as 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. Accordingly, there is a need for a clear basis as to why offsetting is prohibited on cash margin arrangements.

- 1.7 In addition to the reasoning in paragraphs BC62 and BC63 of ED, the right to collateral assets is conditional to a future event, and as such, we support the proposal to prohibit offsetting of collateral assets and liabilities, and its associated financial assets and financial liabilities.

2 Multi-lateral set off arrangements (Question 3)

- 2.1 We support the IASB's conclusion that, although multi-lateral offsetting is likely to be unusual, there is no basis for explicitly excluding multi-lateral set off arrangements from the scope of offsetting if all the criteria proposed in paragraph 6 of ED are met.

3 Cost burden versus user benefit disclosures (Question 4)

- 3.1 We support the disclosure requirements in paragraphs 11-15. We feel that the cost of disclosures would not be too burdensome keeping in view their benefits.

4 Transition (Question 5)

- 4.1 We support the proposed retrospective transition requirements in Appendix A of ED. However, there should be sufficient lead time, say two years, for entities to reassess their existing set off arrangements and to accommodate changes to their information systems.