



April 25, 2011

Via website posting: <http://www.iasb.org/>

Re: Exposure Draft Comment: **Offsetting Financial Assets and Liabilities(ED/2011/1)**

Dear Sir/Madam:

The Certified General Accountants Association of Canada (CGA-Canada) welcomes the opportunity to comment on the Exposure Draft: **Offsetting Financial Assets and Liabilities(ED/2011/1)**. In addition to responses to the specific questions, we have also provided additional comments on certain related matters.

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?

Comments

We support the IASB's proposal to establish an over-arching principle for the offsetting of financial assets and financial liabilities, to retain the existing criteria in IAS 32 for offsetting financial assets and financial liabilities, and to use, as a basis for the converged requirements, the existing guidance for offsetting financial assets and financial liabilities in IAS 32 *Financial Instruments: Presentation*, with some refinements. We also agree with the proposal to clarify that the right to set-off the financial asset and the financial liability must be unconditional and legally enforceable in all circumstances. We note that these criteria are currently applied under existing IAS 32, and we believe that they result in a faithful representation of the underlying economic event, being a *net* cash inflow or outflow, and, therefore, ensure the relevance of the information that is provided to the users of financial statements. We do not believe that the accounting requirements for offsetting should be aligned with those of prudential regulation. We are strongly of the view that the objective of financial reporting is to provide decision-useful information to various groups of users in making decisions about providing resources to the entity. We believe that, in general, it is possible that accounting standards may be developed in such a way that they satisfy the needs of both prudential supervisors and other groups of users. However, we appreciate that, in this specific case, there are some significant differences, as the Basel Framework for prudential regulation focuses on depicting the net credit exposure of an entity to a counterparty, and, therefore, permits netting in a wider range of circumstances than IFRSs. We acknowledge that it may not be

possible to reconcile such differences and believe that, where there are divergent interests, the needs of investors and creditors must take precedence over the wide range of measures that prudential regulators may require institutions to adopt. We note that the ED includes application guidance on periodic re-assessment of the right of set-off in paragraph C15, which clarifies that a conditional right can become unconditional, after the occurrence of a contingent event. However, a right to set-off that is exercisable only before a specific date or that may be removed by a future event, does not meet the offsetting criteria. It is our understanding that the purpose of the application guidance is to *clarify* the requirements included in the main text, rather than to introduce important additional requirements. As currently drafted, the main text of the ED does not include any requirements in respect of re-assessment of the right of set-off; therefore, we believe it would be more appropriate to move them from the appendix to the main text. We further note that paragraph 71 of IAS 12 *Income Taxes* and paragraph 116 of IAS 19 *Employee Benefits* include offsetting criteria, which are drafted in a way similar to the current offsetting criteria in IAS 32 for financial assets and liabilities. We suggest that the Board consider whether any consequential amendments are needed to these two standards, since they both explicitly refer to the offsetting guidance of IAS 32.

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?

Comments

We agree with the proposal to clarify that the right to set-off the financial asset and the financial liability must be unconditional and legally enforceable in all circumstances and that, only if the right has these two characteristics, the entity has the ability to settle net or simultaneously, and that this ability is ensured. We also agree that the net amount of the financial instruments executed within an agreement which provides for conditional right to set-off helps in describing the net credit exposure of the entity to a counterparty, because such an agreement is currently used for mitigating the credit risk. However, we agree with the Board that this information is better presented in the notes to the financial statements, and that netting on the basis of one type of risk (credit risk) is not a sufficient condition for net presentation on the face of the statement of financial position. We agree with the Board that net presentation on the face of the primary statement would, in this case, obscure other risks (counterparty, operational or market risks), and we are of the opinion that these risks are also present in the case of zero net credit exposure. In addition, we believe that, in order to be consistent with the objective of general purpose financial reporting, the amounts presented on the face of financial statements should faithfully represent the cash flows, which an entity expects in the ordinary course of the business (focusing on the liquidity profile of the transaction). Therefore, the offsetting of financial assets and financial liabilities would not be appropriate if the outcome of the transaction was contingent on a future event.

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?

Comments

We agree with the proposal to keep the scope of the offsetting guidance unchanged and to require offsetting for both bilateral and multilateral arrangements that meet the offsetting criteria, as proposed in the ED. We agree with the IASB's conclusion that, although multilateral offsetting is likely to be unusual, there is no basis for explicitly excluding multilateral netting arrangements from the scope of offsetting, if all of the other criteria, including legal enforceability, are satisfied 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?

Comments

We agree with the proposal to require disclosures about rights to offset financial assets and financial liabilities of an entity, and the related arrangements, including information about collateral and master netting arrangements. We also agree that information should be sufficiently disaggregated so as to not obscure important differences between the different types of rights of set-off or related arrangements. We understand that different groups of users may have different needs, and that some users may require information about gross positions for their analyses regardless of the fact that the actual cash inflows or outflows occur as a net position. Therefore, we believe that both sets of numbers (gross and net) would be useful for users of financial statements. We believe that the proposed disclosures would enable users to see the linkages between the gross and the net amounts, and the relationship between financial assets and financial liabilities. We agree that this information should be provided in the notes to the financial statements. We note that paragraphs 36(a) and (b) of IFRS 7 require disclosures related to an entity's credit risk, including information about collateral and other credit enhancements. We also note that, currently, the level of detail in disclosures about collateral and other credit enhancements, including the amounts that could be settled under a netting agreement, varies. The different level of detail reduces comparability between entities and complicates analysis by users. Therefore, we broadly support the proposal to specify clearly the requirements for disclosures about financial assets and financial liabilities that the entity has a conditional right to set-off. We believe that this requirement would increase consistency in the level of detail of information provided, and would, therefore, improve the comparability between entities. However, the proposals in the ED would expand significantly the disclosure requirements in respect of one specific aspect of financial instruments, and taking IFRS 7 as a whole, this level of detail could be seen as disproportionate compared to the other disclosure requirements. We believe that the IASB should provide a rationale as to why such detailed disclosure requirements are needed for one specific aspect of financial instruments, whilst in respect of other topics, IFRS 7 sets out more general principles for disclosures. We also note that consultation documents on other active phases of the IAS 39 *Financial Instruments: Recognition and Measurement* replacement project propose other specific disclosure requirements. Therefore, we suggest the IASB consider the proposals in the ED in the context of the existing disclosure requirements in IFRS 7, taking into account the disclosure proposals made in other consultation documents in respect of accounting for financial instruments, and to ensure that the level of guidance included in the standard remains consistent and balanced across topics.

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.*

Comments

We support the proposed transition requirements. We believe that all new, or amended, accounting requirements should be applied retrospectively, because this significantly enhances the comparability and usefulness of the information provided, and, hence, support the proposed retrospective application. We also believe that the effective date of the proposals should not necessarily be aligned with the application of IFRS 9 *Financial Instruments*, and that early adoption can be permitted.

Additional Comments

We note that the ED clarifies, but does not change, the current IFRS requirements for offsetting of financial assets and financial liabilities, and that it expands current requirements of IFRS 7 in respect of credit risk and specifies disclosure requirements about rights to offset financial assets and financial liabilities of an entity, and the related arrangements, including information about collateral and master netting arrangements. The level of changes for each individual entity would depend on the level of detail currently provided in financial statements. We expect that the benefits resulting from the proposals would outweigh the costs related to it.

Should you wish to discuss the contents of this comment paper or require further elaboration on any of the items presented herein, please do not hesitate to contact Kamallesh Gosalia at kgosalia@cga-canada.org or alternatively the undersigned at rlefevre@cga-canada.org.

Sincerely,

[Original Signed By:]

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Vice-President, Research & Standards