



Department of Treasury and Finance

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Mr Kevin Stevenson
 Chairman
 Australian Accounting Standards Board
 PO Box 204
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Dear Mr Stevenson

ED 209 Offsetting Financial Assets and Financial Liabilities

The Heads of Treasuries Accounting and Reporting Advisory Committee (HoTARAC) welcomes the opportunity to provide comments to the Australian Accounting Standards Board (AASB) on the International Accounting Standards Board (IASB) Exposure Draft: *Offsetting Financial Assets and Financial Liabilities*.

HoTARAC commends the boards on their efforts to achieve greater comparability through a common approach to offsetting financial assets and liabilities. HoTARAC believes the proposed presentation better aligns balance sheet presentation with the commercial and economic reality of the transaction, as it reflects the manner in which the transaction will actually be settled and the future cash flows. This provides users with additional information regarding the nature and amounts of the entity's economic resources and claims against the entity, which is useful for assessing the entity's liquidity and solvency.

HoTARAC supports the proposal, noting the following for the Boards consideration:

- Consequential amendments may be required to other Accounting Standards, which apply similar offsetting criteria, or which uses similar terminology.
- HoTARAC believes that the proposed disclosures need to be further reviewed by the IASB within the overall context of IFRS 7 *Financial Instruments: Disclosures*, to ensure that the level of guidance in that standard is consistent and appropriate across all areas. Additionally, HoTARAC seeks clarification on the intent behind paragraph C16 given that IFRS 7 paragraph 6 already explains how to determine a class of financial instruments.

HoTARAC advises that the proposal would continue to cause an issue conceptually with GAAP/GFS harmonisation, as the revised offsetting presentation conflicts with the GFS requirement, which requires that financial assets and financial liabilities be presented on a gross basis.

Comments by HoTARAC on questions from the exposure draft are attached.

If you have any queries regarding HoTARAC's comments, please contact Peter Gibson from the Australian Department of Finance and Deregulation on 02 6215 3551.

Yours sincerely



Grant Hehir

CHAIR

**HEADS OF TREASURIES ACCOUNTING AND REPORTING ADVISORY
COMMITTEE**

14 April 2011

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HoTARAC Response to AASB ED 209: Offsetting Financial Assets and Financial Liabilities (proposed amendments to AASB 7 and AASB 132, and proposal relating to Tier 2 disclosure requirements)

AASB Specific Matters for Comment

The AASB would particularly value comments on the following:

1. whether, overall, the proposals would result in financial statements that would be useful to users;

Yes. HoTARAC considers the proposals would assist users by improving comparability between entities, and supports the views of BC7(e) that the proposals would provide information that would be useful to users.

2. whether there are any regulatory issues or other issues arising in the Australian environment that may affect the implementation of the proposals, particularly any issues relating to:

(a) not-for-profit entities; and

No comment.

(b) public sector entities;

HoTARAC is not aware of any issues other than the GAAP/GFS harmonisation issue outlined below.

3. whether there are any implications for GAAP/GFS harmonisation;

HoTARAC notes that there will continue to be issues in GAAP/GFS harmonisation, as the GFS manual prohibits netting off financial assets against financial liabilities. In practice, the impact may vary depending on the jurisdiction and the activity.

4. whether the proposals are in the best interests of the Australian and New Zealand economies

Given the improved comparability that would be achieved between entities in all countries that adopt the proposed new requirements, HoTARAC considers the proposals are in the best interests of Australia, in particular in the instance New Zealand were to adopt the ED proposals.

5. unless already provided in response to specific matters for comment 1 – 4 above, the costs and benefits of the proposals relative to the current requirements, whether quantitative (financial or non-financial) or qualitative; and

Overall, HoTARAC believes the proposals would provide benefits to users; however, the Boards should have regard to the additional costs required to research and determine the unconditional legal enforceability of set-off rights in all circumstances for all relevant financial assets and financial liabilities. The extent of costs/effort required will vary between entities, according to factors like the range of different contractual arrangements entered into and the number of jurisdictions in which counter-parties are located (as alluded to in paragraphs C5 and C6).

6. whether the proposed disclosures (paragraphs 11 – 15 and C16 – C20) in this Exposure Draft should also be applied to Tier 2 entities. The AASB proposes to exempt Tier 2 entities from providing any of the proposed disclosures

While at this stage, HoTARAC's jurisdictions have yet to make a decision as to whether they will adopt the Reduced Disclosure Requirements, HoTARAC supports the AASB's proposed exemption.

For questions 1 – 5, respondents should indicate whether they are commenting in relation to Tier 1, Tier 2 or both.

Given that HoTARAC's jurisdictions potentially comprise both Tier1 and Tier 2 entities, the comments generally cover both Tiers. However, if Tier 2 entities are exempted from all the proposed disclosures, this will erode slightly the comparability between entities in Australian and other countries (re the responses to questions 1 and 4 above).

HoTARAC Response to IASB ED 2011/1: Offsetting Financial Assets and Financial Liabilities

General Comments

HoTARAC commends the boards on their efforts to achieve greater comparability through a common approach to offsetting financial assets and liabilities. HoTARAC believes the proposed presentation is in a manner which:

- better aligns balance sheet presentation with the commercial and economic reality of the transaction by reflecting the manner in which the transaction will actually be settled and the future cash flows;
- provides additional information regarding the nature and amounts of the entity's economic resources and claims against the entity; and
- is useful for assessing the entity's liquidity and solvency.

HoTARAC supports the proposal, subject to the following:

- The "objective" paragraphs (paragraphs 4 and 5) appear to paraphrase the authoritative "presentation" statement. This may create confusion.
- HoTARAC seeks clarification on paragraph C16. If it is the ED's intent to require grouping of financial assets and financial liabilities into classes, paragraph 6 of IFRS 7 *Financial Instruments: Disclosures* already explains how to determine a class, which should be consistent across all financial instrument disclosures. In this instance, HoTARAC would strongly recommend for the ED to be consistent with IFRS 7. Alternatively, the ED's intent may be to require the grouping by categories of financial instruments, in this instance, paragraph C16 should be reworded accordingly.
- Consequential amendments may be required to other Accounting Standards, which apply similar offsetting criteria, or which uses similar terminology.
- HoTARAC believes that the proposed disclosures need to be further reviewed by the IASB within the overall context of IFRS 7, to ensure that the level of guidance in that standard is appropriate across all areas.
- HoTARAC recommends that the meaning of the last sentence of paragraph C18 be clarified in the context of the disclosure limitations in paragraph 12(f)(i) and (ii). HoTARAC interprets the latter paragraphs as preventing disclosure of over-collateralisation.

IASB Invitation to Comment

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?

- 1.1 HoTARAC notes that the proposed offsetting criteria are largely consistent with current requirements, other than the addition of ‘unconditional’ to the criteria.
- 1.2 HoTARAC generally agrees with the proposed requirement, noting the following for the Boards consideration:
 - 1.2.1 The “Objectives” paragraphs (paragraphs 4 and 5) contain different wording to the authoritative “presentation” requirements in paragraph 6. In order to avoid possible confusion, HoTARAC suggests to replacing paragraphs 4 and 5 with ‘this [draft] IFRS establishes a principle for offsetting financial assets and financial liabilities’.
 - 1.2.2 HoTARAC believes that consequential amendments may be required to other Accounting Standards, which apply similar offsetting criteria, such as IAS 12 (paragraph 71) and IAS 19 (paragraph 116), or which use similar terminology, such as IAS 1, paragraph 69(d) (which refers to ‘unconditional’).

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?

- 2.1 HoTARAC agrees with the proposed requirements, based on the arguments outlined in BC30 through BC56.

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?

- 3.1 HoTARAC agrees with the proposed requirement, noting that it is largely consistent with current requirements, other than the addition of 'unconditional' to the criteria.
- 3.2 HoTARAC supports the proposal to require offsetting for both bilateral and multilateral set-off arrangements. HoTARAC is of the opinion that presentation and disclosure should be consistent for all situations which meet the criteria in paragraph 6. This is in keeping with the concept of principles-based standards.

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?

- 4.1 HoTARAC broadly agrees with the proposed disclosure requirements.
- 4.2 In order to improve readability of the tables after paragraph IE1, the columns 'net amount of assets (liabilities) in the statement of financial position' (column iii) should be separated more clearly from the rest of the table. These columns reconcile back to the statement of financial position, and are likely to be a 'starting point' for users who are trying to understand the new disclosures.
- 4.3 HoTARAC seeks clarification on paragraph C16. If it is the ED's intent to require grouping of financial assets and financial liabilities into classes, paragraph 6 of IFRS 7 already explains how to determine a class, which should be consistent across all financial instrument disclosures. In particular, HoTARAC is concerned that the phrase "and the applicable rights of set-off" at the end of paragraph C16 may result in the use of different classes just for the "set-off" disclosures. In this instance, HoTARAC would strongly recommend for the ED to be consistent with IFRS 7. Alternatively, the ED's intent may be to require the grouping by categories of financial instruments, in this instance, paragraph C16 should be reworded accordingly.
- 4.4 HoTARAC recommends that the meaning of the last sentence of paragraph C18 be clarified in the context of the disclosure limitations in paragraph 12(f)(i) and (ii). HoTARAC interprets the later paragraphs as preventing disclosure of over-collateralisation.
- 4.5 HoTARAC believes that the proposed disclosures need to be reviewed within the overall context of IFRS 7, to ensure that the level of guidance in that standard is appropriate across all areas. HoTARAC is concerned that the level of detail proposed

may be inconsistent with the more principles-based approach adopted for the other IFRS 7 disclosures. HoTARAC also notes that as a result of the proposal, there may be some overlap with the existing IFRS 7 disclosure requirements regarding collateral (refer IFRS 7 paragraphs 14, 15, 36(b) and 38).

- 4.6 HoTARAC commends the Boards for including the illustrative tables in IE1. These tables provide an effective and efficient summary of the information required by paragraph 12, which on initial reading may appear to impose onerous requirements on entities. However, HoTARAC notes that due to the increased level of disclosure created by the additional information on related arrangements, the requirements could potentially be onerous for some entities
- 4.7 HoTARAC also commends the Boards for adding paragraph 15, which clarifies the Boards' intentions and assists preparers in complying with requirements.

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.*

5.1 (a) HoTARAC agrees with the proposed transition requirements, provided there is sufficient lead time to properly research and determine the unconditional legal enforceability of existing set-off arrangements. An effective date for these set-off proposals that is consistent with the revised effective date for IFRS 9 would seem most appropriate.

(b) The time taken to implement the proposed requirements would depend on factors specific to the entity such as previous offsetting practices and the nature and volume of financial assets and financial liabilities held by the entity. A particular area of concern would be the effort required to research and determine the unconditional legal enforceability of set-off rights in all circumstances for all relevant financial assets and financial liabilities. The extent of costs and effort required will vary between entities, according to factors like the range of different contractual arrangements entered into, the number of jurisdictions in which counter-parties are located etc (as alluded to in paragraphs C5 and C6).