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Mr. Steve Ong
Director, Standard Setting
Hong Kong Institute of Certified Public Accountants
37/F., Wu Chung House
213 Queen's Road East
Wanchai, Hong Kong

Dear Steve,

IASB Exposure Draft on Offsetting Financial Assets and Financial Liabilities ("Exposure Draft")

I refer to your letter to our Mr. Mark Dickens dated 1 February 2011 on the above which has been passed to me for my attention.

We have completed our review of the Exposure Draft and our views are set out below.

General

The Exposure Draft proposes to establish a common principle for offsetting financial assets and financial liabilities and address the current different offsetting requirements under IFRSs and US GAAP.

The Exposure Draft proposes that the offset of a recognised financial asset and a recognised financial liability will be required when the following two criteria are both met:

Criteria 1. The entity has an unconditional and legally enforceable right to set-off the financial asset and the financial liability.

Criteria 2. The entity intends either to settle the financial asset and the financial liability on a net basis, or to realise the financial asset and settle the financial liability simultaneously.

We generally support the Exposure Draft's proposal as it aims to clarify the criteria that must be met for the set-off of financial assets and financial liabilities. However, we note that the proposals under the Exposure Draft may be inconsistent with the IASB's other proposals on Hedge Accounting, which allows two separate transactions to be considered

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together and presented as a single transaction even though the parties to the two separate transactions are with different parties and there is no legally enforceable agreement between the parties for the set-off of the two transactions. We believe that the IASB should consider and explain the conceptual reasons for the apparent inconsistent proposals and which treatment, namely, whether the set-off requirements or the hedging requirements, should take precedence, and also provide guidance on when and why. Moreover, we would comment that a legal enforceable right would provide for the set-off of "contractual" amounts payable and receivable, but under accounting standards financial assets and financial liabilities are required to be stated at their fair value or amortised cost which would be different from their contractual amounts. The IASB may wish to consider how the difference should be accounted for and described in financial statements.

Gross settlements

The Exposure Draft proposes that settlements may be made on a net basis or alternatively on a gross basis so long as the settlements are made simultaneously. We believe that gross settlement, which represent separate settlements, would appear to be inconsistent with the concept of set-off even if the two settlements are made "simultaneously". The IASB may therefore wish to reconsider and expand its guidance on the meaning of the latter part of the second criteria (i.e. *"to realise the financial asset and settle the financial liability simultaneously"*). This latter part appears to indicate that the amounts were required to be settled gross and thus there was, in substance, no right or agreement for set-off.

Alternatively, the IASB may wish to consider whether the two criteria should be further refined to just one criteria which could read as follows:-

> *"The entity has a legally enforceable unconditional obligation to set-off the financial asset and financial liability."*

This simplified criteria will clearly link the two key requirements of "unconditional" and "legally enforceable"; and the use of the word "obligation" to replace the word "right" will remove the practical difficulties that may arise in assessing whether the intention of net settlement is met. We believe a "right to set-off" is not the same as an "obligation to set-off". A "right" provides an option which may or may not be exercised. However, an "obligation" is clear as to whether two or more balances relating to relevant transactions must be set-off for the purpose of determining net outstanding claims payable by or to a counterparty at a particular point in time. We believe that by making the criteria an unconditional "obligation" appropriate set-off would be properly and consistently made for all the relevant transactions.

The removal of the proposed criteria 2 will also remove the need to consider whether settlement of the financial asset and financial liability is made "simultaneously". Under paragraph 48 of IAS 32, "simultaneously" is required to be interpreted to mean settlements made at the "same moment". Intra-day settlement is not enough and would not represent simultaneous settlement. We believe that in practice simultaneous settlement as defined in IAS 32 would normally be impossible or at least very difficult to achieve.

In summary, we believe that the principle should be that set-off should only be required when there is a legally enforceable unconditional obligation to set-off. In all other cases the amounts receivable and payable to other parties should be shown gross.

We also note that the Exposure Draft proposals will require set-off in the primary financial statements but will also require the supplementary disclosure of gross amounts under paragraph 12 of the Exposure Draft. This appears inconsistent. We believe that adoption of the principle of an "obligation" to set-off, as suggested in the refined criteria mentioned above, would more properly reflect the actual obligations and true cash flows arising from the relevant transactions.

We hope that the above comments are helpful.

Yours sincerely,
For and on behalf of
The Stock Exchange of Hong Kong Limited

Colin Chau
Senior Vice President
Listing Division

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c.c. Mr. Mark Dickens JP – Head of Listing