



Derecognition

Proposed amendments to IAS 39 and IFRS 7

Exposure Draft ED/2009/3

Kai Haussmann

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Overview

1. Background and timetable
2. Objectives of the Exposure Draft `Derecognition´
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1. Background and timetable (1)

Joint research project undertaken by the IASB and the FASB (2005)

- Improvement and convergence of the current requirements in IAS 39 and SFAS 140
- Simplification of the complex rules in IAS 39

Memorandum of Understanding (2006)

- Publication of the results of the research project in a due process document (DP or ED) in 2008

Financial Crisis

- Recommendations of the Stability Forum regarding off-balance sheet activities

→ Acceleration of the project led to the immediate publication of an exposure draft without a previous discussion paper



1. Background and timetable (2)

Exposure Draft `Derecognition`

- Published 31 March 2009
- Public roundtables on 15 and 16 June 2009 (together with ED 10 *Consolidated Financial Statements*)
- Comments on this Exposure Draft to be submitted until 31 July 2009
- Deliberations of comments received together with the FASB
- Final standard expected in the 1st half of 2010



2. Objectives of the Exposure Draft `Derecognition´

The proposals are aimed at improving the current requirements for the derecognition of financial assets and liabilities. They seek to improve the assessment of when a financial asset should be derecognised and are also aimed at providing users of financial statements with more and better information about an entity's risk exposure.

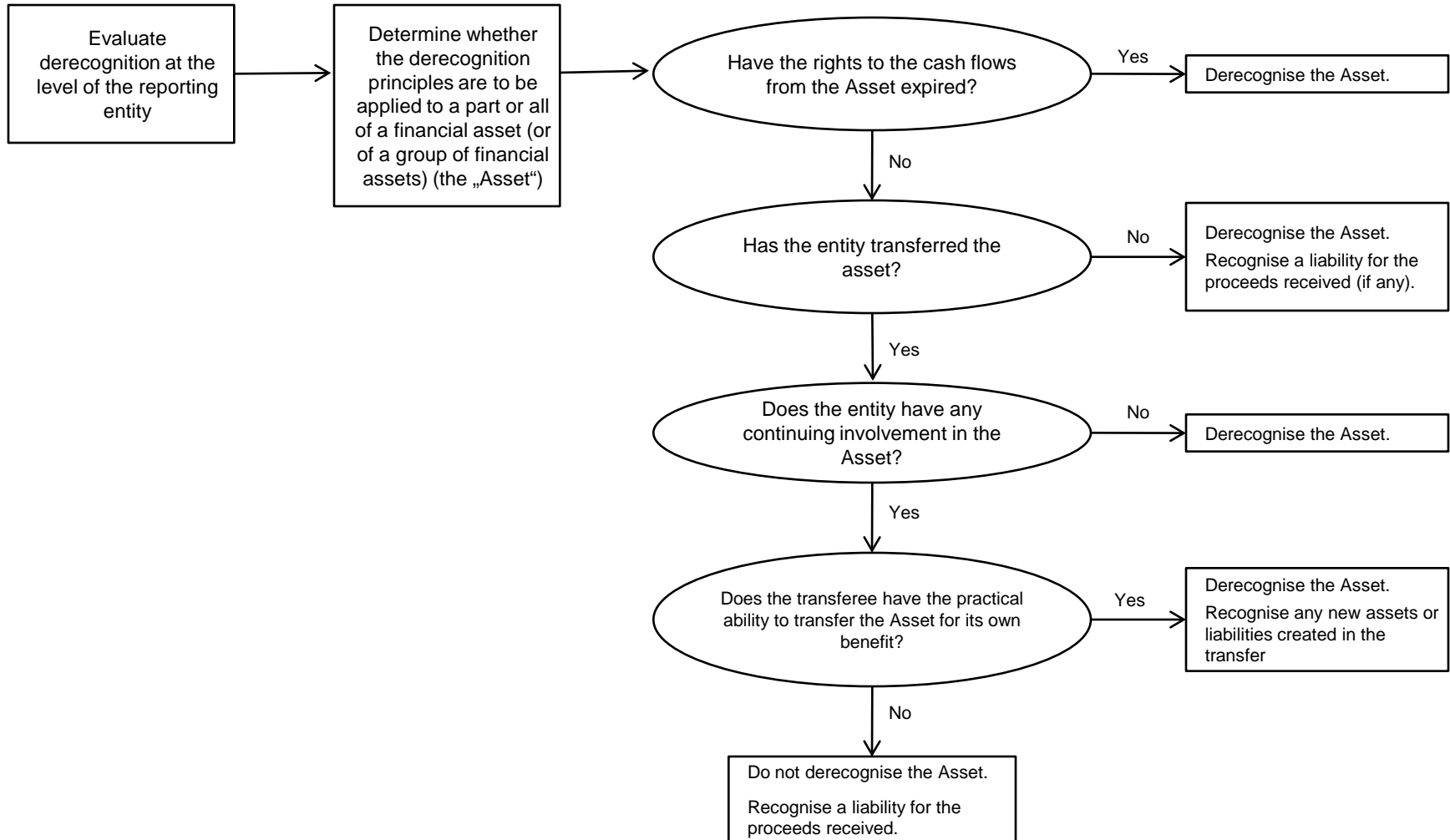


3. Content of the Exposure Draft `Derecognition`

- 3.1 Flowchart of the proposed approach
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3.1 Flowchart of the proposed approach



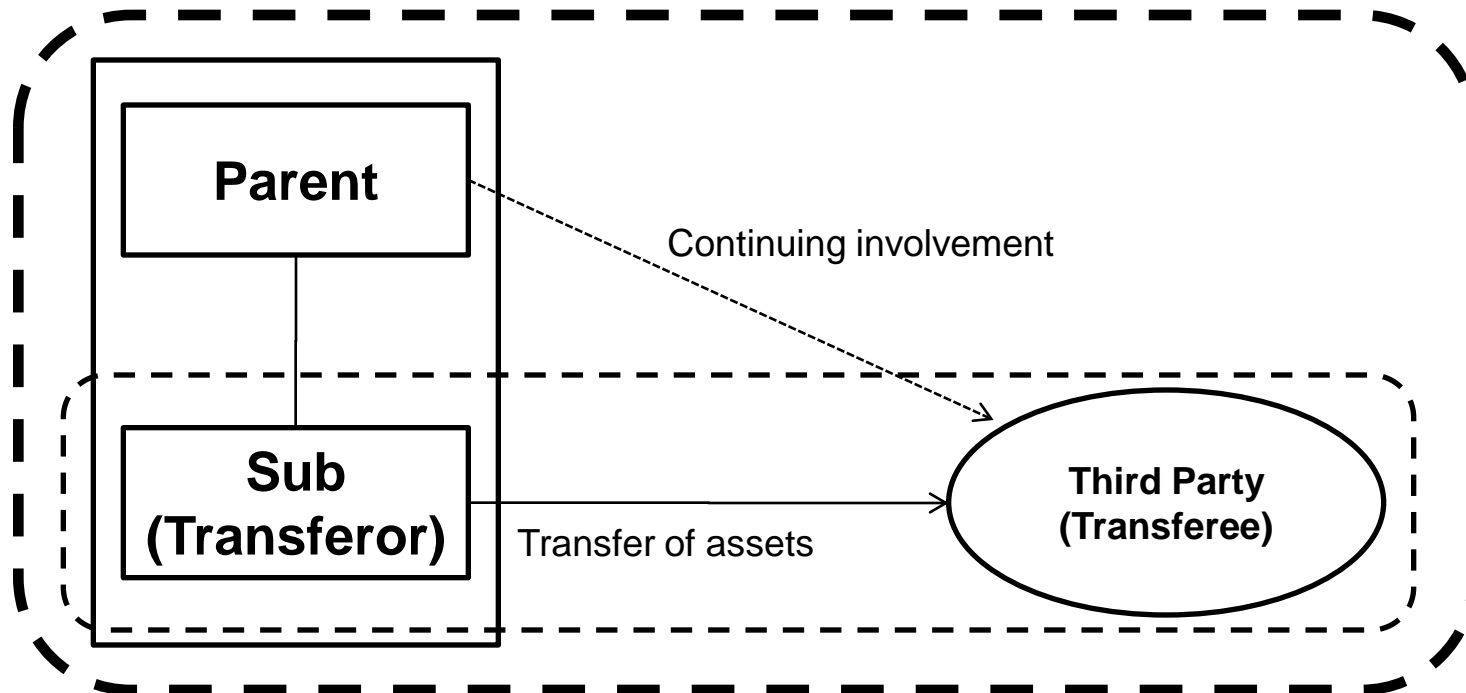


3.2 Level for assessment (1)

- The ED proposes that the guidance (i.e. what is ‘the Asset’ and the assessment of continuing involvement) is to be applied at reporting entity level.
- If the reporting entity is a group, first all subsidiaries have to be consolidated and then the derecognition requirements are applied.

3.2 Level for assessment (2)

- Illustrative example¹:



¹: Source: IASB presentation at EFRAG-TEG meeting in April 2009



3.2 Level for assessment (3)

Question 1 – Assessment of ‘the Asset’ and ‘continuing involvement’ at reporting entity level

Do you agree that the determination of the item (ie the Asset) to be evaluated for derecognition and the assessment of continuing involvement should be made at the level of the reporting entity (see paragraphs 15A, AG37A and AG47A)? If not, why? What would you propose instead, and why?



3.3 'The Asset' to be assessed (1)

- Application of the derecognition requirements basically on the financial asset in its entirety.
- 'The Asset' can only be a part of a financial asset (or a group of financial assets) if it comprises
 - specifically identified cash flows, or
 - a proportionate share of the cash flows from a financial asset (or a group of financial assets)

(i.e. the performance of the part retained does not depend on the performance of the part transferred, and vice versa).
- Is the same as currently in IAS 39.16.



3.3 'The Asset' to be assessed (2)

Question 2 – Determination of 'the Asset' to be assessed for derecognition

Do you agree with the criteria proposed in paragraph 16A for what qualifies as the item (ie the Asset) to be assessed for derecognition? If not, why? What criteria would you propose instead, and why?

(Note: The criteria proposed in paragraph 16A are the same as those in IAS 39.)



3.4 Definition of a transfer

- The ED proposes the following definition to be included in IAS 39.9:
„A *transfer* takes places when one party passes, or agrees to pass, to another party some or all of the economic benefits underlying one or more of its assets. The term ‘transfer’ is used broadly to include all forms of sale, assignment, provision of collateral, sacrifice of benefits, distribution and other exchange. (A transfer does not necessarily result in derecognition.)“

Question 3 – Definition of ‘transfer’

Do you agree with the definition of a transfer proposed in paragraph 9? If not, why? How would you propose to amend the definition instead, and why?



3.5 Continuing involvement(1)

- The ED provides a filter regarding continuing involvement in the evaluation chart to allow derecognition in indisputable cases without further test steps.
 - According to par. 17A(b) the entity shall derecognise the Asset if the entity
 - transfers the Asset and
 - has no continuing involvement in it.
 - The entity has no continuing involvement in the Asset if, as part of the transfer, it neither retains any of the contractual rights or obligations inherent in the Asset nor obtains any new contractual rights or obligations relating to the Asset (par. 18A).
- no interest in the future performance of the Asset



3.5 Continuing involvement (2)

- None of the following constitutes continuing involvement:
 - normal representations and warranties relating to fraudulent transfer and concepts of reasonableness, good faith and fair dealings that could invalidate a transfer as a result of legal action;
 - the retention of the right to service the Asset in a fiduciary or agency relationship; or
 - forward, option and other contracts associated with reacquiring the Asset, for which the contract (or exercise) price is the fair value of the transferred Asset.

Question 4 – Determination of ‘continuing involvement’

Do you agree with the ‘continuing involvement’ filter proposed in paragraph 17A(b), and also the exceptions made to ‘continuing involvement’ in paragraph 18A? If not, why? What would you propose instead, and why?



3.6 'Practical ability to transfer' test (1)

- If the entity retains a continuing involvement in the transferred Asset, another test is to be performed (par. 17A(c)) → The entity shall derecognise the transferred Asset only, if the transferee has the practical ability to transfer the Asset for the transferee's own benefit.
- The guidance in AG51A of the ED requires to meet the following three criteria:
 - „Unilaterally“: ability to dispose of the Asset independently of the actions of others;
 - „Without having to impose additional restrictions“: ability to dispose of the Asset in isolation;
 - „For its own benefit“: ability to keep for itself the consideration received.



3.6 ‘Practical ability to transfer’ test (2)

- Determining whether these criteria are met requires judgement, after considering all the relevant facts and circumstances. Some factors to consider in making that determination are the following¹:

Factors to consider (judgement required)	
Terms of the transfer (contractual) arrangement	
Nature of the Asset (fungibility and obtainability)	Readily obtainable?
Market for the Asset	Enough potential buyers? Market convention?
Transferee’s ability to obtain full economic benefits	Right to match a bona fide offer?
Economic constraints	Economically impeded from selling the asset?

¹: Source: IASB presentation at EFRAG-TEG meeting in April 2009



3.6 ‘Practical ability to transfer’ test (3)

Question 5 – ‘Practical ability to transfer for own benefit’ test

Do you agree with the proposed ‘practical ability to transfer’ derecognition test in paragraph 17A(c)? If not, why? What would you propose instead, and why?

(Note: Other than the ‘for the transferee’s own benefit’ supplement, the ‘practical ability to transfer’ test proposed in paragraph 17A(c) is the same as the control test in IAS 39.)

Do you agree with the ‘for the transferee’s own benefit’ test proposed as part of the ‘practical ability to transfer’ test in paragraph 17A(c)? If not, why? What would you propose instead, and why?



3.7 Accounting for retained interests (1)

- ED par. 21A: Allocation of the carrying amount of a financial Asset, of which only a part has been transferred (and derecognised) shall be done on the basis of the relative fair values of the part retained and the part transferred → consistent with the current procedure in IAS 39.34
- ED par. 22A relates to transactions in which the entity, after transferring an entire financial asset or group of financial assets which qualifies for derecognition, purchase an interest in the transferee as part of the transfer. The entity shall treat such interest as a retained part of the asset or group of assets previously recognised. If the transferee has other financial assets or liabilities in addition to those received from the transferring entity, the transferring entity shall split the interest purchased between
 - a) an interest in the previously recognised asset or group of assets, and
 - b) an interest in new assets or new liabilities.→ allocation following the guidance in par. 21A.



3.7 Accounting for retained interests (2)

Question 6 – Accounting for retained interests

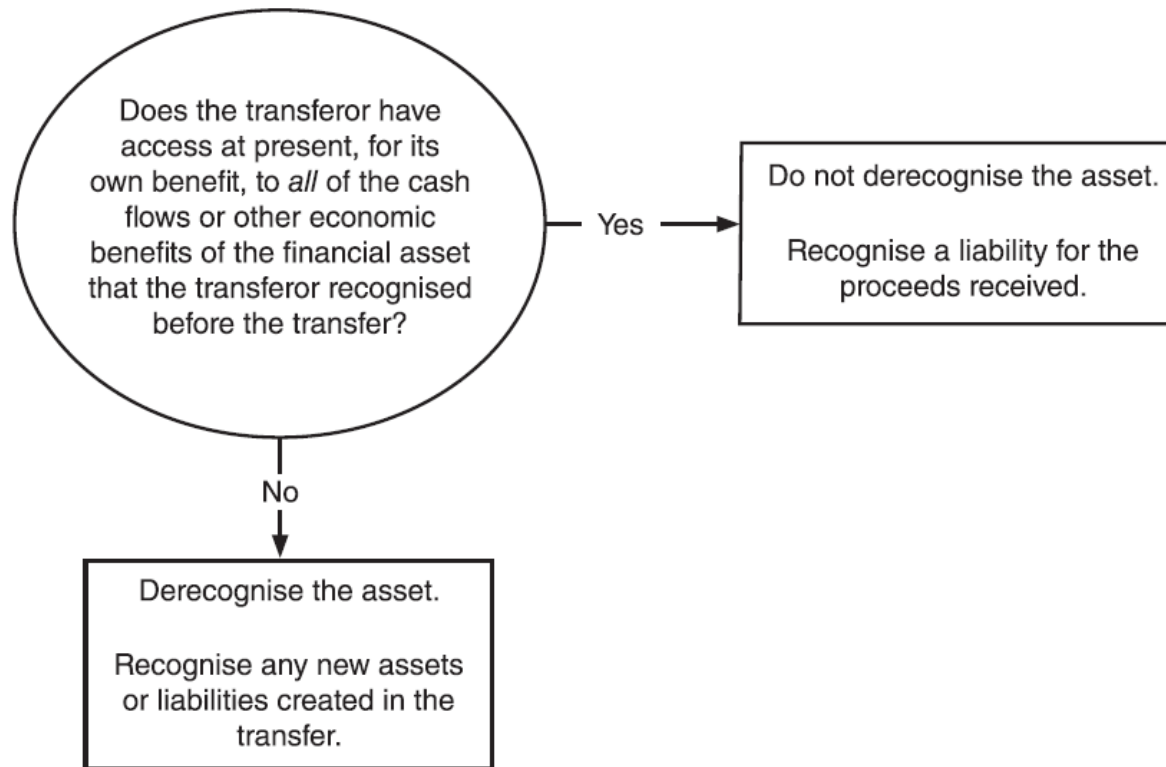
Do you agree with the proposed accounting (both recognition and measurement) for an interest retained in a financial asset or group of financial assets in a transfer that qualifies for derecognition (for a retained interest in a financial asset or group of financial assets, see paragraph 21A; for an interest in a financial asset or group of financial assets retained indirectly through an entity, see paragraph 22A)? If not, why? What would you propose instead, and why?

(Note: The accounting for a retained interest in a financial asset or group of financial assets that is proposed in paragraph 21A is not a change from IAS 39. However, the guidance for an interest in a financial asset or group of financial assets retained indirectly through an entity as proposed in paragraph 22A is new.)



3.8 Alternative Approach (1)

- A minority of five IASB members disagree with the approach proposed in the ED and prefer an alternative approach with the following derecognition flowchart:



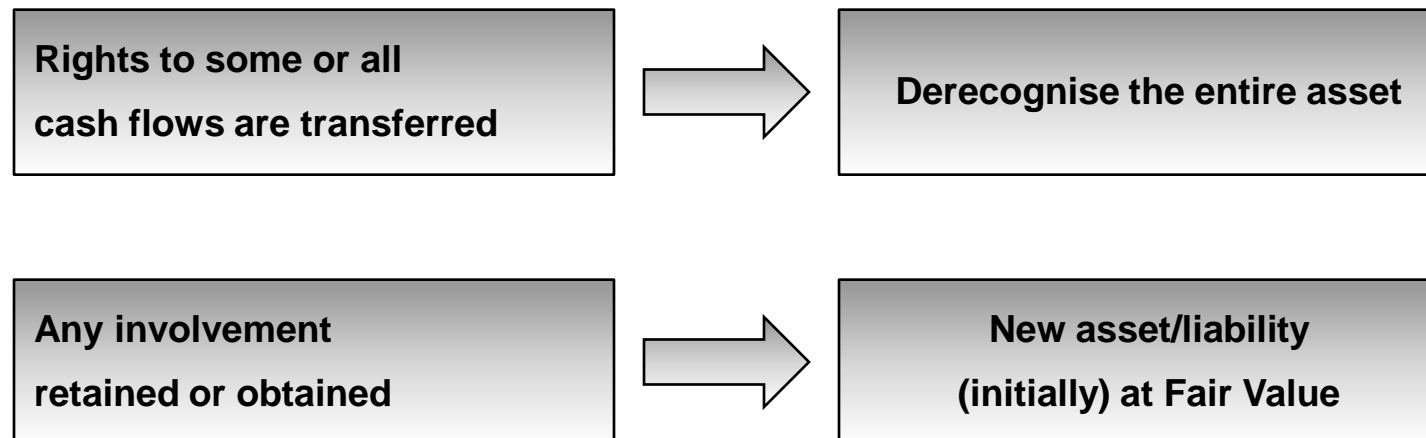


3.8 Alternative Approach (2)

Derecognition criteria

- „An entity derecognises an asset if it ceases to have **present access, for its own benefit**, to **all** of the cash flows or other economic benefits of the asset.“

Implications¹





3.8 Alternative Approach (3)

Question 7 – Approach to derecognition of financial assets

Having gone through the steps/tests of the proposed approach to derecognition of financial assets (Questions 1-6), do you agree that the proposed approach as a whole should be established as the new approach for determining the derecognition of financial assets? If not, why? Do you believe that the alternative approach set out in the alternative views should be established as the new derecognition approach instead, and, if so, why? If not, why? What alternative approach would you propose instead, and why?



3.9 Interaction between consolidation and derecognition (1)

- Consistency of derecognition principle with the approach in ED 10 *Consolidated Financial Statements*
- The focus is on 'Control'
- Illustrative example¹:

Consolidation: ED10 (Entity level)	Derecognition ED (Asset/Liability level)
Power to direct activities of another entity to generate returns	Ability to obtain (access) the underlying future economic benefits
For the reporting entity	For its own benefit

¹: Source: IASB presentation at EFRAG-TEG meeting in April 2009



3.9 Interaction between consolidation and derecognition (2)

Question 8 – Interaction between consolidation and derecognition

In December 2008, the Board issued an exposure draft ED 10 *Consolidated Financial Statements*. As noted in paragraphs BC28 and BC 29, the Board believes that its proposed approach to derecognition of financial assets in this exposure draft is similar to the approach proposed in ED 10 (albeit derecognition is applied at the level of assets and liabilities, whereas consolidation is assessed at the entity level). Do you agree that the proposed derecognition and consolidation approaches are compatible? If not, why? Should the Board consider any other aspects of the proposed approaches to derecognition and consolidation before it finalises the exposure drafts? If so, which ones, and why? If the Board were to consider adopting the alternative approach, do you believe that that approach would be compatible with the proposed consolidation approach?



3.10 Derecognition of financial liabilities (1)

- ED contains a revised approach to derecognition of financial liabilities to be more consistent with the definition of a liability in the IASB Framework.
- A ‘settlement approach’ will replace the current ‘legal release approach’.
- The following comparison of the wording used demonstrates the differences of the approaches:

<u>IAS 39</u>	<u>ED/2009/3</u>
39 An entity shall remove a financial liability (or a part of a financial liability) from its statement of financial position when, and only when, it is extinguished – ie when the obligation specified in the contract is discharged or cancelled or expires.	39A An entity shall derecognise a financial liability (or a part of it) when it (or the part) no longer qualifies as a liability of the entity. A financial liability ceases to qualify as a liability of an entity if the present obligation is eliminated and the entity is no longer required to transfer economic resources in respect of that obligation.



3.10 Derecognition of financial liabilities (2)

Question 9 – Derecognition of financial liabilities

Do you agree with the proposed amendments to the principle for derecognition of financial liabilities in paragraph 39A? If not, why?
How would you propose to amend that principle instead, and why?



3.11 Effective Date and Transition

- An entity shall apply the proposed amendments **prospectively** to transactions entered into after the effective date (to be determined).
- Early adoption will be permitted if an entity discloses the fact and applies the amendments to all transactions from that date.
- Clarification, that transfers entered into before the effective date do not have to be corrected retrospectively as a result of the changes in the derecognition requirements.

Question 10 - Transition

Do you agree with the proposed amendments to the transition guidance in paragraphs 106 and 107? If not, why? How would you propose to amend that guidance instead, and why?



3.12 Disclosures (1)

- Amendments to IFRS 7 contain further disclosures for a better understanding of risk exposure of the entity¹.

Transferred assets NOT derecognised (On-balance sheet)	Transferred assets derecognised (Off-balance sheet)
Relationship between transferred (but not derecognised) assets and associated liabilities	Nature of and risks from continuing involvement

¹: Source: IASB presentation at EFRAG-TEG meeting in April 2009



3.12 Disclosures (2)

Transferred assets NOT derecognised (On-balance sheet)

- Nature of the assets
- Nature of the risks to which the entity remains exposed
- Carrying amounts of the assets and the associated liabilities
- Description of nature of the relationship between the assets and the associated liabilities
- Fair Value of the assets, Fair Value of the associated liabilities and the net position, if recourse only to the assets

Source: IASB presentation at EFRAG-TEG meeting in April 2009



3.12 Disclosures(3)

Transferred assets derecognised (Off-balance sheet)

- | | |
|---|---|
| <ul style="list-style-type: none">• Carrying amount and Fair Value if the continuing involvement• Maximum exposure to loss from continuing involvement• Fair Value of derecognised assets in which the entity has continuing involvement• Cash outflows to repurchase assets• Maturity analysis of future cash outflow• Sensitivity analysis• Qualitative information | <ul style="list-style-type: none">• Gain or loss recognised• Income and expense recognised from continuing involvement• If transfer activity not evenly distributed✓ Total amount of activity and related gains/losses in the period, and✓ When greatest activity took place• Any additional information necessary |
|---|---|

Source: IASB presentation at EFRAG-TEG meeting in April 2009



3.12 Disclosures (4)

- The new IG40A inserted in the guidance on implementing IFRS 7 illustrates some possible ways to meet the quantitative disclosure requirements.

Question 11 - Disclosures

Do you agree with the proposed amendments to IFRS 7? If not, why? How would you propose to amend those requirements instead, and why?



Deutsches Rechnungslegungs Standards Committee e.V.
Accounting Standards Committee of Germany



Kai Haussmann

Tel. 030 20 64 12 14
haussmann@drsc.de

Zimmerstr. 30
10969 Berlin

Fax 030 20 64 12 15

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www.drsc.de