April 2009

Exposure Draft

Snapshot: Derecognition (Proposed amendments to IAS 39 and IFRS 7)

This snapshot is a brief introduction to proposed amendments to IAS 39 *Financial Instruments: Recognition and Measurement* and IFRS 7 *Financial Instruments: Disclosures.* It provides an overview of the core proposals presented by the International Accounting Standards Board (IASB) in the exposure draft.

The proposals form part of the IASB's response to the G20 conclusions and the recommendations of the Financial Stability Forum.

Project objective:	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.
Project stage:	In response to the global financial crisis and following the conclusions of the G20 and the recommendations of the Financial Stability Forum, the IASB accelerated its project work and decided to proceed directly to the publication of an exposure draft (ED). The purpose of an ED is to seek public input on the proposed amendments.
Comment deadline:	The ED is open for public comment until 31 July 2009.
Next steps:	The IASB intends to hold public round tables to discuss the proposals in June or July 2009. The IASB expects to issue final amendments to IAS 39 and IFRS 7 in the first half of 2010.

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Why is the IASB undertaking this project?

The derecognition requirements in IAS 39 determine when a financial asset or a financial liability should be removed from an entity's statement of financial position (balance sheet).

Assessing whether or not a financial asset or a financial liability may be derecognised is often straightforward. However, the assessment can be very difficult when dealing with very complex legal and other structures, such as special purpose vehicles used for the securitisation of financial assets.

Over the past years, the use and complexity of such structures has increased considerably. The potential effects have been highlighted by the financial crisis. Financial reporting standards need to respond to the changed environment by providing requirements that can be widely understood and consistently applied to complex structures. The standards also need to provide users with more information about the risk to which an entity is exposed by complex legal and other structures.

The IASB has accelerated its project and the proposals are aimed at addressing the issues arising from the existing requirements, in particular:

Existing requirements are complex and internally inconsistent. This makes them difficult to understand and apply consistently.

The complexity of the current requirements results from a mixture of different concepts being used to assess whether an asset should be derecognised. The current requirements in IAS 39 combine elements of various derecognition concepts, such as risks and rewards, control and continuing involvement. This complexity is further increased by the fact that these different approaches must be applied in a specified order.

Current disclosure requirements do not provide sufficient information to allow users to assess the ongoing risks related to off balance sheet assets.

The financial crisis has demonstrated that current disclosure requirements need improvement. Specifically, users need more information to be able to assess any remaining risks that arise from assets that have been removed from the balance sheet.

Creating a global set of requirements is crucial to regaining users' confidence.

The current approaches to derecognition of financial assets in IFRSs and US standards are substantially different. US standards are also internally inconsistent and difficult to apply. The derecognition requirements are therefore part of the convergence programme of the IASB and the US Financial Accounting Standard's Board (FASB) detailed in the boards' Memorandum of Understanding. As a result of the financial crisis, the FASB is making some short-term amendments to its existing requirements (SFAS 140) while the IASB has accelerated its project in response to the recommendations of the G20 and the Financial Stability Forum. Therefore the proposed amendments were not published as a joint exposure draft. However, both boards recently re-emphasised their commitment to continue their work towards joint derecognition requirements.

What is the scope of the project?

The proposed amendments would replace derecognition and related disclosure requirements within IAS 39 and IFRS 7.

What is the IASB proposing?

The ED proposes a new approach for derecognition and improved disclosure requirements in IFRS 7.

A single approach to derecognition based on 'control'

The ED proposes a revised approach for assessing whether financial assets or financial liabilities should be removed from the balance sheet. Rather than combining elements of several derecognition concepts (ie risks and rewards, control, and continuing involvement) the proposed approach to the derecognition of financial assets is based on a single concept – 'control'.

Under the proposed approach an entity should derecognise a financial asset when:

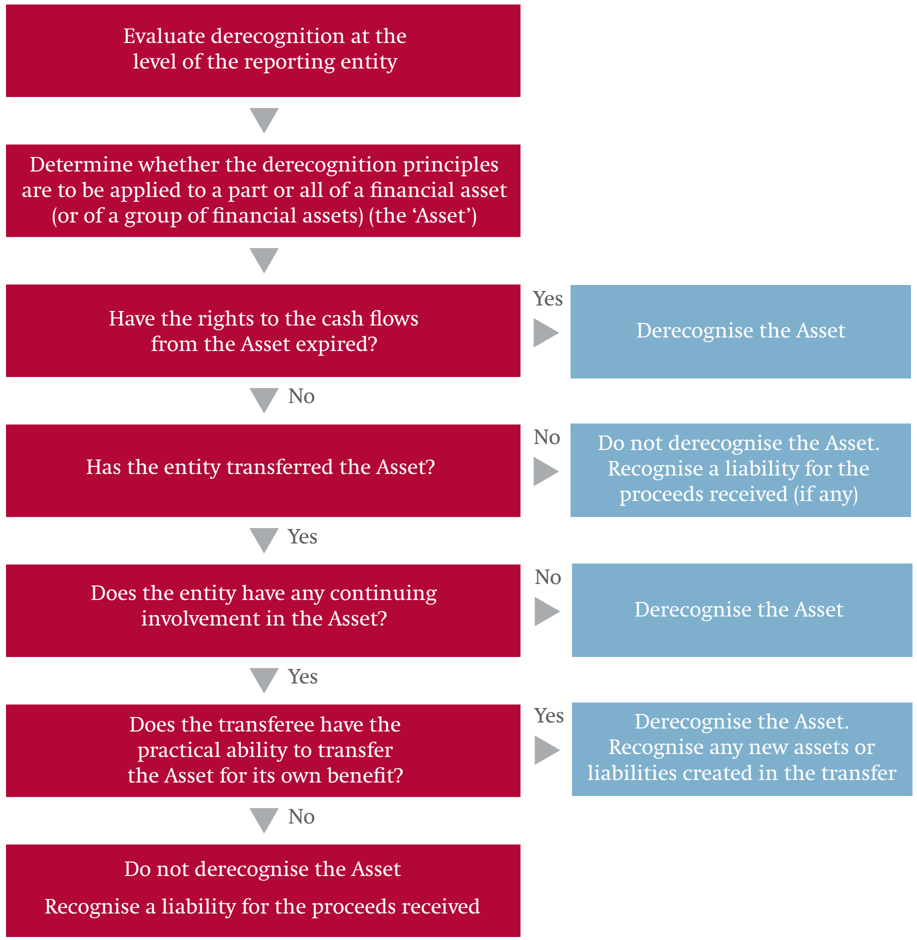
- the contractual rights to the cash flows from the financial asset expire;
- the entity transfers the financial asset and has no continuing involvement in it; or
- the entity transfers the financial asset and retains a continuing involvement in it but the transferee (the entity that buys the financial asset) has the practical ability to transfer the financial asset for the transferee's own benefit.

Improved and expanded disclosures

The ED proposes to extend and improve the current derecognition-related disclosures for both transferred assets that remain on the balance sheet and those that are derecognised to allow users of financial statements:

- to understand better the relationship between transferred financial assets that are not derecognised and the associated liabilities; and
- to evaluate an entity's risk exposure associated with its ongoing involvement in derecognised financial assets, ie any residual exposure arising from assets that have been removed from the balance sheet.

The proposed approach can be depicted as follows:



What might be the effects of the proposed changes?

The changes should make it easier for users to understand and evaluate an entity's decision about on and off balance sheet items.

Unlike IAS 39, the proposed approach does not combine elements of several derecognition concepts but focuses on a single notion of control.

The absence of:

- an explicit risks and rewards test;
- pass-through requirements; and
- a requirement for a transferor (the entity transferring or selling the asset) to recognise and measure a financial asset to the extent of its continuing involvement

should result in derecognition requirements that are easier for preparers to understand and apply consistently. The changes should make it easier for users to understand and evaluate an entity's decision about on and off balance sheet items.

Additional information should allow for a better understanding of an entity's risk exposure arising from transferred assets that are not derecognised.

The proposed amendments would allow users to understand better the relationship between transferred financial assets that remain on the balance sheet, and the associated liabilities. Specifically, the proposed disclosures would provide users with better information about the extent to which an entity can benefit from an asset that has been transferred but remains on the balance sheet. Access to these benefits may be limited because the entity (transferor) may be obliged to pass some of the economic benefits of the asset to the entity to which the asset was transferred.

Moreover, the proposed disclosures should improve the ability of a user to identify liabilities that will be settled entirely from the proceeds received from specific assets without recourse to any other assets of the entity.

> The IASB's proposals seek to improve the existing derecognition and disclosure requirements.

Enhancing the disclosure requirements for derecognised financial assets would allow users to better assess the risk exposure of an entity resulting from its continuing involvement in derecognised assets.

In particular, users should benefit from the proposed disclosure of the nature, timing, ranking, amount and uncertainty of any obligations or cash outflows relating to the entity's continuing involvement in transferred assets and the details about those assets.

Aligning the derecognition requirements for financial liabilities will contribute to greater clarity

The IASB's proposals also address the derecognition for financial liabilities. These amendments are aimed at mirroring the proposals for the derecogntion of assets. Doing so would increase the symmetry of the requirements and thus contribute to making the guidance easier to understand and apply. However, the IASB expects that the proposals would not significantly change current practice for derecognising financial liabilities.

Areas of discussion

The IASB is seeking input on all the proposals presented in the ED.

In particular, the IASB had detailed discussions about the assessment of control and the conditions under which a financial asset or a financial liability should be derecognised. It is therefore especially interested in feedback on this area.

Is the ability to transfer a financial asset a sufficient indicator for control?

Some Board members think that the transferee's ability to transfer a financial asset is only one aspect of control. Accordingly, they favour an approach ('alternative approach') that focuses on whether the entity that transfers an asset retains access to all the economic benefits of that financial asset after the transfer. Under this approach, if an entity transfers an asset and does not retain access to all the economic benefits of that financial asset after the transfer, the transferor would derecognise the transferred asset and recognise the rights and obligations either retained or obtained in the transfer transaction.

For example, forward contracts, puts, calls, guarantees or disproportionate involvement with respect to transferred cash flows would not result in failed sales and would not result in the recognition of a liability for the proceeds received. However, the transferor would recognise any involvement and measure that involvement at the date of transfer at fair value.

How can I comment on the ED?

The ED includes questions related to the IASB's proposals. Respondents are invited to comment on any or all of those questions and to comment on any other issue that the boards should consider in finalising their proposals. The IASB's deliberations will, as usual, take place in public board meetings as announced on the IASB website.

The deadline for comments on the ED is 31 July 2009. To view the ED and submit your comments, visit www.iasb.org.

More information about measures undertaken by the IASB in response to the G20 conclusions and the recommendations of the Financial Stability Forum is available on www.iasb.org/financial+crisis.

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