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**International  
Accounting Standards  
Board**

*This document is provided as a convenience to observers at IASB meetings, to assist them in following the Board's discussion. It does not represent an official position of the IASB. Board positions are set out in Standards.*

*These notes are based on the staff papers prepared for the IASB. Paragraph numbers correspond to paragraph numbers used in the IASB papers. However, because these notes are less detailed, some paragraph numbers are not used.*

## **INFORMATION FOR OBSERVERS**

**Board Meeting:** December 2008, London  
**Project:** Derecognition of Financial Assets and Liabilities  
**Subject:** Summary of Decisions and Open Issues (Agenda Paper 10A)

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### **Background**

1. At the IASB and IASB/FASB meetings in October, the staff presented to the boards the following proposed derecognition principle for financial assets:

An entity should derecognise a financial asset or component thereof when it no longer qualifies as an asset of the entity (ie when the future economic benefits no longer exist or the future economic benefits exist but the entity ceases to have the ability to (a) obtain the future economic benefits inherent in the asset/component and (b) restrict others' access to those benefits).
2. The staff proposed two possible approaches to making that principle operational:
  - a. **Approach 1** – A transferor of a financial asset or a component thereof (herein thereafter referred to as 'the Asset') should derecognise the Asset if:
    - i. the transferor has no continuing involvement in the Asset,
    - ii. the transferee:

1. has the practical ability to transfer the Asset to a third party for its own benefit, and
    2. is able to exercise that practical ability unilaterally and without needing to impose additional restrictions on the transfer, or
    - iii. the transferee presently has other access to the economic benefits underlying the Asset for its own benefit.
  - b. **Approach 2** – excludes criterion (iii) above, restricts what items could qualify as part or a component of an asset, and requires linked presentation if specified conditions are met.
3. Flowcharts illustrating the two approaches are shown in the appendix. The two flowcharts are the same as the ones that the staff presented at the October meetings.
4. A majority of the members on each board expressed a preliminary preference for Approach 2, but raised some issues for the staff to address in developing both approaches further.
5. The staff presented a summary of those issues at the November meeting. Furthermore, the staff discussed some of those issues with the Board at the IASB meeting in November.
6. This paper
  - a. provides a summary of all the issues raised by the boards at the October meetings,
  - b. highlights those issues which the staff presented to the Board and for which the Board made tentative decisions at the November meeting, and
  - c. lists those issues that are still open (including any sweep issues from the November meeting) to be tackled at this (December) and future board meetings.
7. This paper also states the decisions made by the Board in November.

## Inventory of Issues (Resolved and Open)

8. At the November meeting, the staff provided a summary of open issues that the boards raised at the October meetings (see table below). The summary follows the steps/tests in the two flowcharts (except for Issue 10, which deals with derecognition of financial liabilities while the two flowcharts deal with derecognition of financial assets).
9. The staff believes that the remaining open issues must be addressed before an exposure draft on derecognition can be issued.

	Open Issues	Timing	Paper Reference	Status
1	What is 'the Asset'?	November	Paper 15B	Resolved
2	What is the definition of 'continuing involvement'?	November	Paper 15E	Resolved
3	What does it mean for the transferee to have the 'practical' ability to transfer the asset it purchased from the transferor? Does this test require a continuous assessment of 'practical' ability?	November	Paper 15C	Resolved (except for sweep issue below)
4	Can/should we change the 'practical ability to transfer' test (both flowcharts) and 'other access' test (Flowchart 1 only) to assess them from the perspective of the transferor?	November	Paper 15D	Resolved (except for sweep issue below)
1b	Sweep/unresolved issues from November meeting: <ul style="list-style-type: none"> <li>The Asset: If a transfer involves a part of a derivative, an embedded derivative that requires bifurcation or an equity instrument, does that part qualify as a component?</li> <li>'Practical Ability to Transfer' test: Does a written put option on a non-readily obtainable financial asset really constrain a transferee from transferring the asset to a third party, and if so how?</li> <li>Transferor's perspective: Why does a transfer of a non-readily obtainable financial asset with a physically-settled forward purchase at a fixed price (or a physically-settled total return swap) qualify for derecognition under Flowchart 1 when the perspective of the derecognition tests is changed from that of the transferee to that of the transferor?</li> </ul>	December	Paper 10B	
3a			Paper 10C	
4a			Paper 10D	
9	When should financial liabilities be derecognized?	December	Papers 10E+F	

1a	Sweep/unresolved issues from November + December meetings <ul style="list-style-type: none"> <li>The Asset: Do financial assets that are transferred as a group have to be similar and if so when are they considered similar?</li> </ul>	January	N/A	
5	What are the principles for linked presentation?	January	N/A	
6	How is the carrying amount of the financial asset allocated between the components sold vs. those retained? What is the measurement basis for any such retained component(s)?	January	N/A	
7	Sweep/unresolved issues from January or previous meetings <ul style="list-style-type: none"> <li>How does derecognition interact with consolidation?</li> </ul>	February	N/A	
10	Application of flowcharts to complex derecognition cases	February	N/A	
8	For each flowchart, what will be the disclosure requirements?	February	N/A	

## Tentative Decisions Made

10. At the November meeting, the Board made the following tentative decisions:

**1**

**What is ‘the Asset’ that the two flowcharts assess for derecognition?**

- a. For transfers involving a whole entire asset, transferring the right to the cash flows of a financial asset is akin to transferring the asset itself (ie ‘the Asset’ for purposes of the flowcharts could be ‘the right to the cash flows’).
- b. For transfers involving part(s) of a financial asset(s),
  - i. for Flowchart 1, *any* cash flows that are generated by the financial asset or group of financial assets that a transferor recognised on its statement of financial position before the transfer would qualify as a component of that asset or that group of assets (ie, ‘the Asset’ would be any cash flows), and
  - ii. for Flowchart 2, a part of a financial asset or group of financial asset as so defined in paragraph 16 of IAS 39 would qualify as a component of that asset or that group of assets (ie, ‘the Asset’ would be the component definition in paragraph 16 of IAS 39), subject to specific guidance about
    1. transfers of groups of similar financial assets and

2. derivatives, embedded derivatives that require bifurcation and equity instruments.

2

## What is the definition of 'continuing involvement'?

- a. Continuing involvement in a transferred financial asset or component thereof (the Asset) represents retention of any contractual rights and/or contractual obligations inherent in the Asset or the acquisition of any new contractual rights and/or contractual obligations relating to the Asset (eg, any interest in the future performance of the Asset or a responsibility to make payments in the future in respect of the Asset under any circumstance).
- b. Continuing involvement in a transferred Asset may result from contractual provisions incorporated in the transfer agreement itself or a separate agreement with the transferee or a third party entered into in connection with the transfer.
- c. Continuing involvement does not include:
  - i. *Standard representations and warranties.* 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 do not constitute a continuing involvement in a transferred financial asset.
  - ii. *Fiduciary/agency servicing.* The retention of the right to service a transferred financial asset does not constitute continuing involvement in that asset if
    1. the fees paid to the transferor are compensation for services provided and are commensurate with the level of effort required to provide those services (eg, the service arrangement does not include terms, conditions or amounts that are not customarily present in arrangements for similar services negotiated at arm's length).
    2. the fees are senior in priority to any payment to the transferee from the serviced/transferred assets.
    3. the transferee has the right to terminate the transferor as a servicer.
    4. the transferor does not have any other continuing involvement with the transferred assets than the servicing arrangement.

- iii. *Fair value forwards and fair value options.* Forward purchases, purchased calls and written puts and other contracts for which the contract price is the fair value of the asset transferred do not constitute continuing involvement.

3

**What does it mean for the transferee to have the 'practical' ability to transfer the asset it purchased from the transferor? Does this test require a continuous assessment of 'practical' ability?**

*Meaning of 'practical ability to transfer'*

- a. For a transferee to have the practical ability to transfer a financial asset it purchased from a transferor, it must be in a position immediately after the purchase to transfer the asset to a third party unilaterally and without having to impose additional restrictions on that transfer.
- b. Determining whether a transferee has the practical ability to transfer a financial asset requires judgment considering all the relevant facts and circumstances. Some factors to consider in making that determination are:
  - i. The terms of the transfer (contractual) arrangement
  - ii. Other contracts or arrangements entered into in relation to the transfer
  - iii. The nature of the asset
  - iv. The market for the asset
  - v. The transferee's ability to obtain the full economic benefits
  - vi. Economic constraints.

*Subsequent reassessment of 'practical ability to transfer'*

- c. A transfer that does not qualify for derecognition because the transferee is deemed not to have the practical ability to transfer the asset to a third party will qualify for derecognition if conditions subsequently change so as to give the transferee that ability. Exceptions to this principle are the following:
  - i. Subsequent events that change the probability of an option being exercised (other than the exercise or expiration of the option itself) would not result in a change to the assets and liabilities recognised and derecognised.
  - ii. Once a transferor derecognises a financial asset because it judges that the transferee has the practical ability to transfer that asset to a third party, it will not have to re-recognise the asset if conditions subsequently

change resulting in the transferee no longer having the practical ability to transfer the asset.

4

**Can/should we change the ‘practical ability to transfer’ test (both flowcharts) and ‘other access’ test (Flowchart 1 only) to assess them from the perspective of the transferor?**

- a. The Board decided not to change the perspective from that of the transferee to that of the transferor for the ‘practical ability to transfer’ test in Flowchart 2.
- b. The Board asked the staff to illustrate how a transfer of a non-readily obtainable financial asset with a physically settled fixed-price forward purchase (or physically settled total return swap) would be analysed under Flowchart 1 (and in doing so whether Flowchart 1 might be improved) if the perspective of the ‘practical ability to transfer’ and ‘other access to the asset’s cash flows’ tests were changed from that of the transferee to that of the transferor.

## Remaining Open Issues

### *Sweep/unresolved issues from the November meeting*

11. The sweep/unresolved issues from the November meeting are:

1a

**The Asset: Do financial assets that are transferred as a group have to be similar and if so when are they considered similar? – TO BE DISCUSSED IN JANUARY**

IFRIC was asked to clarify the meaning of ‘similar’ in paragraph 16 of IAS 39 (this is the paragraph that deals with transfers of a part of a financial asset, a financial asset, or a group of similar financial assets). At the November 2006 meeting, IFRIC decided not to take this issue onto its agenda but published the view of the Board that derivatives were not similar to non-derivative financial assets and, accordingly, the derecognition tests in IAS 39 would have to be applied to each type separately if a transfer involved both.

Comment letters received by IFRIC after it rejected to take on the issue indicated that practice continued to believe that paragraph 16 of IAS 39 was not clear enough and thus could lead to some strange outcomes (eg, derecognition of the non-derivative financial assets, but not the derivative assets that were transferred as part of the group and vice versa).

1b

**The Asset: If a transfer involves a part of a derivative, embedded derivative that requires bifurcation or an equity instrument, does that part qualify as a component? – See AGENDA PAPER 10B**

At the November meeting the Board decided to adopt the definition of a part of a financial asset in paragraph 16 of IAS 39 as the components definition for the staff's two flowcharts. The proposed amendment to FAS 140 explicitly precludes an interest in a derivative, an embedded derivative that requires bifurcation and/or an equity instrument from qualifying as components. IAS 39 has no specific guidance on this point. For example, does the transferred receive leg of an interest rate swap asset qualify as a component of that swap asset? As a result, do we need to (or should we) provide similar guidance for the IAS 39 parts definition adopted for the two flowcharts?

3a

**'Practical ability to transfer' test: Does a written put option on a non-readily obtainable financial asset really constrain a transferee from transferring the asset to a third party, and if so how? – See AGENDA PAPER 10C**

Agenda Paper 15C presented by the staff to the Board at the November meeting concluded that a transferee who purchased a non-readily obtainable financial asset together with a fixed-price put option did not have the *practical* ability to transfer that asset. This was because the transferee would be unlikely to forfeit the benefit of the option by transferring the asset in isolation (ie without attaching the option).

Some Board members questioned this conclusion because they believed that the transferee would generally be able to transfer the asset and put option together to a third party and in that circumstance the put option would not represent an additional restriction imposed on the transfer. They believed that the purpose of the 'practical ability to transfer' test was to determine whether a transferor had passed control over a financial asset's cash flows to the transferee and that in the example where the transferee bought a financial asset and a put option all of the control over the asset's cash flows was with the transferee.



4a

**Transferor’s perspective: Why does a transfer of a non-readily obtainable financial asset with a physically-settled forward purchase at a fixed price (or a physically-settled total return swap) qualify for derecognition under Flowchart 1 when the perspective of the derecognition tests is changed from that of the transferee to that of the transferor? – See AGENDA PAPER 10D**

Agenda Paper 15D presented by the staff to the Board at the November meeting indicated that if the Board were to adopt to change the perspective of the derecognition tests in the flowcharts from that of the transferee to that of the transferor, a couple of outcomes under Flowchart 1 would change (those outcomes being a transfer of a non-readily obtainable financial asset with a physically-settled fixed-price forward purchase or physically-settled total return swap).

The Board asked the staff to provide examples illustrating those outcomes and the basis for them.

*Open issues from the October meetings not yet addressed*

12. Other open issues raised by the boards at the October meetings are:

5

**Should linked presentation be part of Flowchart 2? If so, what are the principles for linked presentation? – TO BE DISCUSSED IN JANUARY**

Flowchart 2 provides that in a failed sale, the transferor might be required, if specified conditions are met, to link for presentation purposes the resulting liability with the financial asset that remains on the transferor’s statement of financial position.

Some of the board members that favoured Flowchart 2 questioned whether that flowchart should include linked presentation. They are of the view that linked presentation allowed a transferor to present transfers that did not qualify for derecognition as if they did, therefore putting in doubt the basis for having derecognition criteria.

In the October papers, the staff indicated that it had not yet determined the scope, principle, criteria and measurement of linked presentation, as well as

how items that qualify for linked presentation might be presented on the statement of financial position and in the statement of comprehensive income. Accordingly, for purposes of deciding whether linked presentation should be included in Flowchart 2, the staff will have to develop (and provide the Board with) principles for such presentation technique.

**6**

**How is the carrying amount of the financial asset allocated between the components sold vs. those retained? What is the measurement basis for any such retained component(s)? – TO BE DISCUSSED IN JANUARY**

The staff has not considered whether the current measurement guidance in IAS 39 is appropriate for each of the two flowcharts. For transfers of portion(s) of financial asset(s) that qualify for derecognition, the staff will have to address how the previous carrying amount should be allocated between the portion(s) transferred and those continued to be held. How should the portion(s) continue to be held be measured subsequently?

**7**

**For each flowchart, what will be the disclosure requirements? – TO BE DISCUSSED IN FEBRUARY**

Some board members emphasised to the staff the importance of disclosures. They think disclosures are especially important for Flowchart 1, considering that it will result in significantly more financial assets or portions thereof being derecognised than under Flowchart 2 or under IAS 39 or the proposed amendment to FAS 140.

**8**

**How does derecognition interact with consolidation? – TO BE DISCUSSED IN FEBRUARY**

As the staff has previously stated, it believes that the issue of when to derecognise a financial asset is separate from the issue of when to consolidate an entity. Nevertheless, the staff believes that for purposes of deciding on a derecognition model, it will be beneficial for the boards to have an understanding of those transfers for which the transferor derecognizes the related financial assets under the two derecognition flowcharts but for which it then consolidates the transferee entity under the proposed consolidation model.

The staff notes that the consolidation ED is likely to be published before the staff can complete this work.

**9**

**When should financial liabilities be derecognized? – TO BE DISCUSSED AT THIS MEETING (SEE AGENDA PAPERS 10E+F)**

The staff believes that derecognition of financial assets is a more contentious issue and one on which people find it difficult to agree on a common derecognition principle/criteria than derecognition of financial liabilities. However, because the derecognition project covers the derecognition of *both* financial assets and financial liabilities, the staff will have to consider whether the current derecognition principles for financial liabilities in IAS 39 continue to be appropriate or whether they require amendment.

As part of derecognition of financial liabilities, the staff will also look into particular issues arising from the interaction between the derecognition approaches for financial liabilities and financial assets.

**10**

**Application of flowcharts to complex cases – TO BE DISCUSSED IN FEBRUARY**

The staff plans to test the flowcharts when they are complete (ie issues 1-9 have been resolved) against some transactions that are more complicated than those it put forth at the October meetings.

13. The staff plans to put forth papers on the remaining issues (items 5-8 and 10) and any sweep/unresolved issues from the December meeting over the next couple of months, as so indicated in the table in paragraph 9.
14. The staff has shared this paper with the FASB staff. It also plans to share the papers in the foregoing table with the FASB staff and obtain their input on any issues which they have already dealt with in the past.

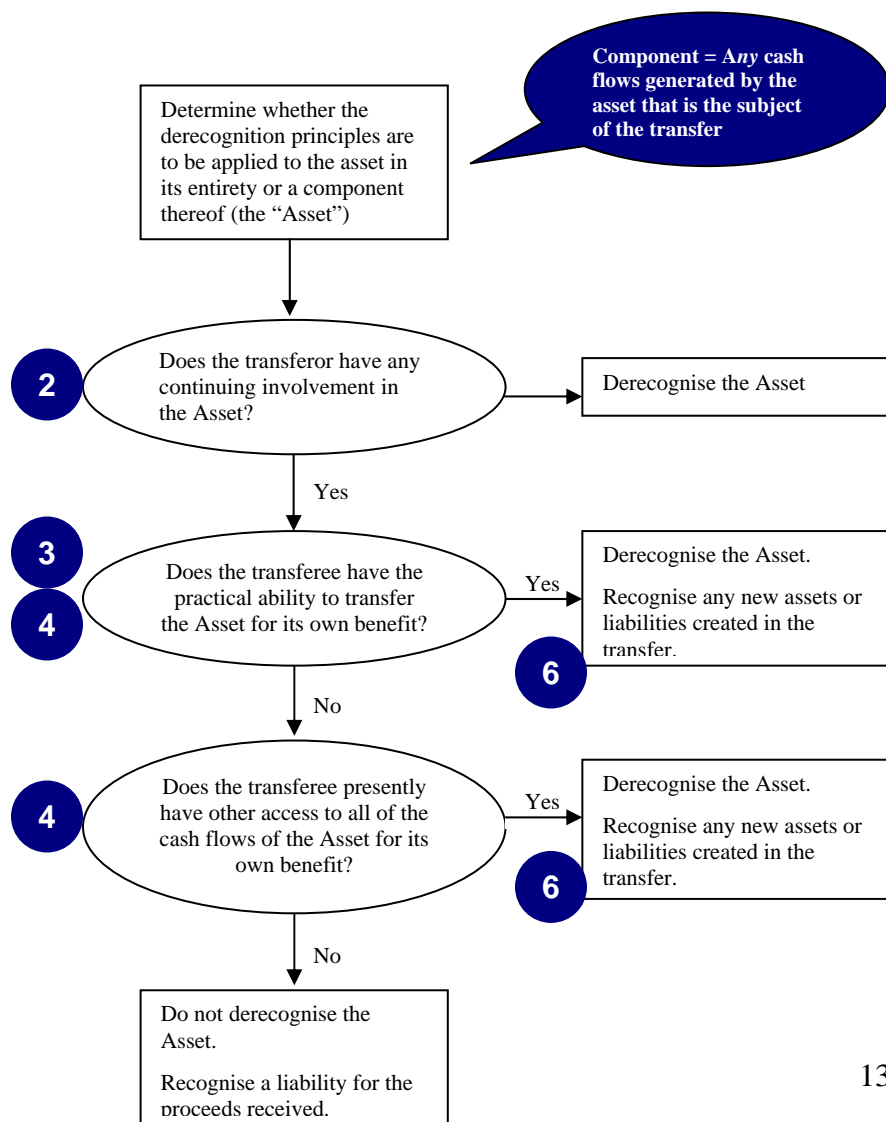
## **Questions for the Board**

15. Does the summary in paragraph 10 accurately reflect the tentative decisions made by the Board at the November meeting? If not, how so?

16. Does the table in paragraph 9 capture all of the remaining issues that need to be addressed before issuing an exposure draft on derecognition of financial assets and liabilities? If not, what other issues do you want the staff to address?
17. Do you agree with the proposed timing? If not, why not?

## Appendix: Flowcharts Showing Open Issues Raised at October Meetings

**10 7 8** FLOWCHART 1



**10 7 8** FLOWCHART 2

