30 Cannon Street, London EC4M 6XH, United Kingdom
Phone: +44 (0)20 7246 6410 Fax: +44 (0)20 7246 6411
Email: iasb@iasb.org Website: http://www.iasb.org

International Accounting Standards Board

INFORMATION FOR OBSERVERS

Board Meeting: **February 2009, London**

Project: **IAS 39 Financial Instruments: Recognition and Measurement – Derecognition**

Subject: **Comment Period for the ED and Transitional Provisions (Agenda paper 2F)**

Introduction

1 This paper sets out the staff's recommendation, together with supporting analysis, with respect to transitional provisions and comment period deadline for the exposure draft (ED) on derecognition of financial assets and liabilities.

2 The Paper also asks whether the Board agrees with the staff recommendations.

Staff recommendation

3 We recommend Friday **31 July 2009** as the comment period deadline for the exposure draft on derecognition of financial assets and liabilities. Assuming that the Board publishes the exposure draft by 31 March 2009, this will give constituents 120 days to comment on the exposure draft.

4 In respect of transitional provisions, we recommend that the exposure draft includes the following:

a. On initial application of any final guidance, an entity should not recognise financial assets or financial liabilities that it had derecognised prior to implementation of this draft guidance, nor should it derecognise financial assets or financial liabilities that it had recognised prior to implementation of any final guidance. That is, prospective application to new transactions entered into after the effective date.

b. If application of any final guidance would have required recognition of an item that was derecognised under previous accounting, the entity should describe the financial asset involved in the notes until such time as it would have been derecognised in accordance with this guidance.

c. When any final guidance is first adopted, an entity should not restate comparative information. An entity need not present other information required by the draft guidance for comparative periods.

Staff analysis – comment period deadline

5 The IASB Due Process Handbook notes the following regarding the publication of an exposure draft:

> 42 The IASB normally allows a period of 120 days for comment on an exposure draft. If the matter is exceptionally urgent, the document is short, and the IASB believes that there is likely to be a broad consensus on the topic, the IASB may consider a comment period of no less than 30 days. For major projects, the IASB will normally allow a period of more than 120 days for comments.

6 We considered the following when making our recommendation on comment period deadline:

a The derecognition project is a major project. The Board is proposing a new approach to derecognition of financial assets and liabilities which is a significant departure from current practice and may have a major impact on statement of financial position of many entities and would require a greater level of disclosure than currently required.

b The Board did not publish a discussion paper. Therefore, the exposure draft is the first opportunity that constituents will have to comment on the project.

c However, the analysis of the basis and rationale behind the exposure draft has been undertaken in public, providing potential respondents with the opportunity to develop their thinking over the last five months.

d Publication of a revised derecognition guidance is deemed to be urgent. The target publication date for the revised guidance on derecognition is the first half of 2010.

e There is no broad consensus on the topic among Board members (hence two approaches in the ED) and it is unlikely that a broad consensus exists among constituents.

7 Because of a, b and e set out in paragraph 6, we think that it would be inappropriate to shorten the normal comment period for exposure drafts. Similarly, because of d, we think that it would not be appropriate to lengthen the normal comment period.

8 However, some may argue that in view of the urgency of the project and the need for the Board to consider derecognition and consolidation guidance simultaneously, the comment period should be shortened so that the two projects can run in parallel.

9 The staff is sympathetic to this view, but due to the nature and complexity of the project the staff is not recommending a shorter comment period.

Staff analysis – transitional provisions

10 The change to the derecognition model for financial assets and liabilities and the additional guidance on applying the model might result in a reporting entity reaching a different conclusion about derecognition of financial assets and liabilities. Consequently, a reporting entity might be required to derecognise assets previously recognised, and recognise assets that have previously been derecognised because of continuing involvement.

11 We think that there are three options in terms of transition:

a Option A: retrospective application

b Option B: application consistent with the requirements in IFRS 1 *First-time Adoption of International Financial Reporting Standards*.

c Option C: prospective application from the effective date[1]

Option A: retrospective application

12 The change in the derecognition model is similar to a change in accounting policy upon initial application of the new IFRS. IAS 8 *Accounting Policies, Changes in Accounting Estimates and Errors* requires an entity to apply a change in accounting policy retrospectively, unless an IFRS includes specific transitional provisions relating to the change.

13 Retrospective application would result in the most useful information for users. An entity would be required to present its financial statements as if the new derecognition model had always been in place. The information presented for all periods would be fully comparative.

14 However, retrospective application might prove to be costly and extremely difficult, if not impossible, to apply given the transactional focus of derecognition (see also discussion in Option C). Therefore, we do not think that option A is feasible regarding the new derecognition model.

Option B: application consistent with requirements in IFRS 1

15 When the initial application of any new requirements results in the derecognition of financial assets by an entity for the first time, this creates a situation similar to the preparation of the opening statement of financial position for a first-time adopter. Therefore, Option B would propose that if the initial application of the requirements of any new guidance results in the derecognition of a financial asset by an entity, the reporting entity accounts for the transaction in a way consistent with the requirements of IFRS 1.

[1] If the Board decides to permit early adoption of the new IFRS, the reporting entity would conduct the assessment of control on the date that it first applies the new IFRS. References in this paper to the 'effective date' refer to the date that a reporting entity first applies the new IFRS.

16 IFRS 1, in general, provides that if a first-time adopter derecognised non-derivative financial assets or non-derivative financial liabilities under its previous GAAP as a result of a transaction that occurred before adopting IFRS, it shall not recognise those assets and liabilities under IFRSs (unless they qualify for recognition as a result of a later transaction or event).

17 However, IFRS 1 allows a first-time adopter to apply the derecognition requirements in IAS 39 retrospectively from a date of the entity's choosing, provided that the information needed to apply IAS 39 to financial assets and financial liabilities derecognised as a result of past transactions was obtained at the time of initially accounting for those transactions.

18 Both Alternative B and C (prospective application – see below) would or could result in some items that ought to be recognised not being recognised. The omission of material assets or liabilities could undermine the understandability, relevance, reliability and comparability of an entity's financial statements, especially if such transactions are large and will have effects for many years.

19 The staff however, believes that the requirements in IFRS 1 were designed for a specific purpose—the application of IFRSs by entities that have not previously applied IFRSs. The new guidance on derecognition of financial assets and liabilities is different—it applies to entities that prepare financial statement in accordance with IFRSs. We think that it would be inappropriate to apply the requirements in IFRS 1 to a situation other than the one that it was designed to address.

Option C: prospective application from the effective date

20 Option C would require a reporting entity to assess transfer transactions (ie assess whether the transactions qualify for derecognition) by applying the new guidance as from the effective date of the any final guidance.

21 The staff recommends this alternative for the following reasons:

(a) Restating past derecognition transactions would be costly, especially if restatement involves determining the fair value of retained servicing assets and liabilities and other components retained in a complex securitisation.

Furthermore, it may be difficult to obtain information on financial assets held by transferees that are not under the transferor's control.

(b) Retrospective application would not result in consistent measurement, as entities would need to recreate information about past transactions (including measurements) with the benefit of hindsight.

22 As noted in paragraph 13, ideally, assets and liabilities that would not be derecognised under the final guidance should be reinstated on adoption of the final guidance. However, as noted in paragraph 14, the staff believes that it is likely to be unduly onerous to expect entities to change the accounting for derecognition transactions that occurred prior to the effective date of the final guidance. Accordingly, the staff is recommending a prospective application of the final guidance.

23 On the other hand, the omission of material assets or liabilities could undermine the understandability, relevance, reliability and comparability of an entity's financial statements, especially if such transactions are large and will have effects for many years. Hence, to enable users to understand what might be "missing" from the financial statements, the staff recommends that the final guidance should require a general description of the financial assets or financial liabilities that have been derecognised that would not have been derecognised under the final guidance.

Questions for the Board

24 Does the Board agree with the staff recommendation in respect of comment deadline (paragraph 3)? If not, why not? What alternative dates do you suggest, and why?

25 Does the Board agree with the staff recommendation on transitional provisions (paragraph 4)? If not, why not? What amendments or alternative do you suggest, and why?