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International
Accounting Standards
Board

INFORMATION FOR OBSERVERS

Board Meeting: **January 2009, London**

Project: **Derecognition of Financial Assets and Liabilities**

Subject: **Summary of Decisions and open Issues (Agenda Paper 2A)**

Background

1. At the IASB and IASB/FASB meetings in October 2008, the staff proposed to the boards the following 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 (note that for Approach 1, the Board tentatively decided at the December meeting to remove items (i) and (ii) and focus solely on item (iii) – see summary of decisions in Appendix 1):

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. 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.

4. The staff discussed some of those issues with the Board at the IASB meetings in November and December of 2009.

5. This paper is meant to provide the Board with a snapshot of

   a. which of the issues that it (and the FASB) raised at the October meetings have been resolved (including the tentative decisions made by the Board with respect to those issues at the November and December meetings) – see Appendix 1,

   b. which issues are to be resolved at this meeting, and

   c. which ones are open to be deliberated at the February meeting.

6. This paper also shows the two flowcharts reflecting the Board's tentative decisions to date. – see Appendix 2

7. The Board has committed to issuing an exposure draft on derecognition of financial assets and financial liabilities by the end of March 2009. **To the extent**

the Board is unable to reach decisions on the issues that the staff has put forward at this meeting, the project timeline will be delayed.

Issues to be resolved at this meeting

8. The following table shows the issues that the staff intends to discuss with and obtain tentative decisions from the Board at this meeting:

Issue	Important for…	Addressed in…
If a transfer involves a part of a derivative, hybrid instrument with an embedded derivative that requires bifurcation or an equity instrument, does that part qualify as a component?	'The Asset' determination step (first step) in Flowchart 2	**Paper 2B**
Does a transfer of a portion of a financial asset cause the nature of that asset to change so that after the transfer it no longer exists (ie the transfer created beneficial interests in the asset, of which some have been transferred and of which some have been retained by the transferor)? How should any such interests be measured at and subsequent to the transfer date?	Flowchart 1+2	**Paper 2C**
Do financial assets that are transferred as a group have to be *similar* for purposes of being evaluated for derecognition as a group?	'The Asset' determination step (first step) in Flowchart 2	**Paper 2D**
Cover note for linked presentation papers	'Linked presentation' step (last step) in Flowchart 2	**Paper 2E**
What is linked presentation and should it be part of Flowchart 2?		**Paper 2E-1**
What is the scope/principle of linked presentation?		**Paper 2E-2**
Where in the financials (face or notes) should linked presentation be displayed?		**Paper 2E-3**

What should the measurement attribute of the linked assets and liabilities be? How should any created day 1 gain or loss be subsequently accounted for?		**Paper 2E-4**
What are the issues that constituents raised with respect to FASB's exposure draft of FAS 140R, and are there any issues that are also issues for Flowchart 2?	Flowchart 2	**Paper 2F**

Issues to be resolved at February meeting

9. The following table (next page) shows the issues that the staff intends to discuss with and obtain tentative decisions from the Board at the February meeting:

Issue	Details of issue
How does derecognition interact with consolidation?	The staff is of the opinion 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 Board to have an understanding how derecognition interacts with consolidation, in particular for those transfers for which the transferor derecognises the related financial assets under the two derecognition flowcharts but for which it then consolidates the transferee entity under the proposed consolidation model.
Application of flowcharts to complex derecognition cases	The staff plans to test the flowcharts when they have been fully developed against some transactions that are more complicated than those it put forth at the October meetings.
For each flowchart, what will be the disclosure	Some board members emphasised to the staff the importance of disclosures. They think disclosures are especially important for Flowchart 1,

requirements?	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.
Sweep issues from January meeting	To be determined

Questions for the Board

10. Does the summary in Appendix 1 accurately reflect the tentative decisions made by the Board at the November and December meetings? If not, how so?

11. 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?

Appendix 1: Issues raised by the IASB and FASB at the October meetings and tentative decisions made by the IASB with respect to those issues to date

November 2008 meeting

Issue	Tentative decision	Impacts…
What is 'the Asset' to be assessed for derecognition?	1. 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'). 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 consideration of specific guidance about a. transfers of groups of similar financial assets and b. derivatives, embedded derivatives that require bifurcation and equity instruments.	Flowchart 1 + 'The Asset' determination step (first step) in Flowchart 2
What is the definition of 'continuing involvement'?	1. 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).	'Continuing involvement' step (second step) in Flowchart 2

	2. 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. 3. Continuing involvement does not include: a. *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. b. *Fiduciary/agency servicing*. The retention of the right to service a transferred financial asset does not constitute continuing involvement in that asset if i. 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). ii. the fees are senior in priority to any payment to the transferee from the serviced/transferred assets. iii. the transferee has the right to terminate	

	the transferor as a servicer. iv. the transferor does not have any other continuing involvement with the transferred assets than the servicing arrangement. c. *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.	
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'* 1. 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. 2. 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: a. The terms of the transfer (contractual) arrangement b. Other contracts or arrangements entered into in relation to the transfer c. The nature of the asset d. The market for the asset e. The transferee's ability to obtain the full	'Practical ability to transfer' test in Flowchart 2

	economic benefits f. Economic constraints. *Subsequent reassessment of 'practical ability to transfer'* 1. 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: 2. 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. 3. 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.	
Can/should we change the 'practical ability to transfer test to assess it from the perspective of the transferor?	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.	'Practical ability to transfer' test in Flowchart 2

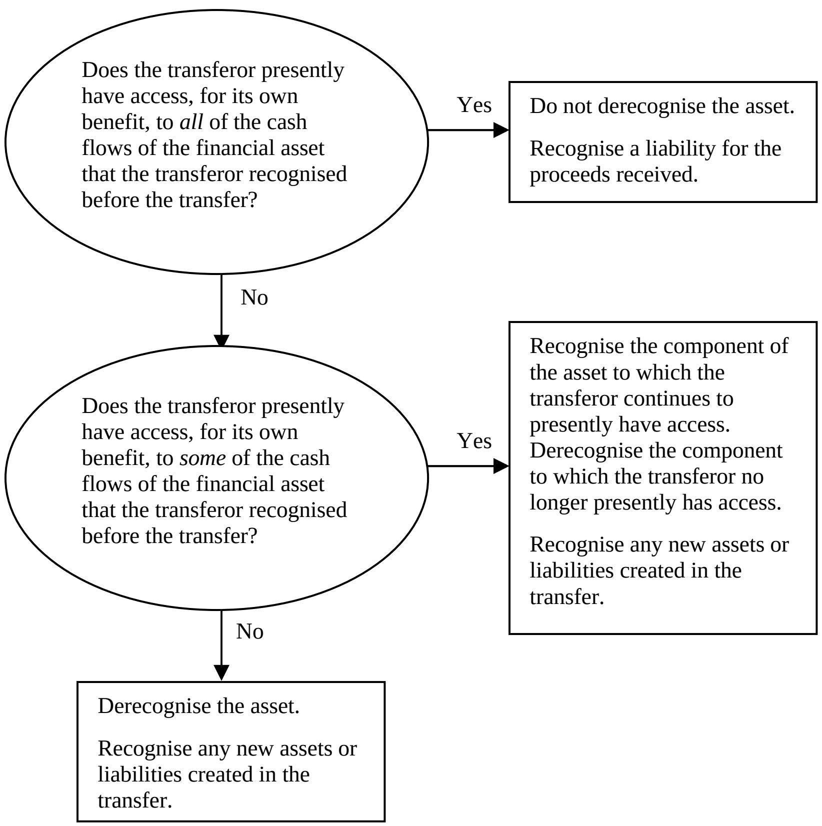
December 2008 meeting

Issue	Tentative decision	Impacts…
‘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?	The outcome of the debate of this issue was that the Board decided to focus solely on whether, after the transfer, the transferor has access to all or some of the cash flows of the financial asset that the transferor recognised before the transfer [ie the Board tentatively decided to eliminate ‘the Asset’ determination and ‘continuing involvement’ steps and the ‘practical ability to transfer’ test].	Flowchart 1
‘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?	The Board decided to continue to include economic constraints (including some options allowing the transferee to put a transferred asset back to the transferor) in the assessment of whether a transferee has the practical ability to transfer to a third party for its own benefit the financial asset that it purchased from the transferor.	‘Practical ability to transfer’ test in Flowchart 2
When should financial liabilities be	The Board tentatively decided on the following derecognition principle for financial liabilities:	Derecognition of financial liabilities

derecognised?	*An entity should derecognise a financial liability or component thereof when it no longer qualifies as a liability of the entity (ie when the present obligation is eliminated and the entity is no longer required to transfer economic resources in respect of that obligation).*	
Interaction between the staff's derecognition approaches for financial assets and liabilities	1. Secured borrowings with recourse and securing assets should be accounted for similarly to unsecured borrowings and unpledged assets. 2. Any restrictions on a debtor's ability to benefit from the securing asset should be addressed by disclosure. 3. Security lending arrangements and repos involving readily obtainable financial assets should qualify for derecognition. 4. The Board made no tentative decisions regarding the accounting for secured borrowings *without* recourse and the related securing assets.	Flowchart 1 + Flowchart 2

Appendix 2: Flowcharts reflecting the Board's tentative decisions to date

FLOWCHART 1



FLOWCHART 2