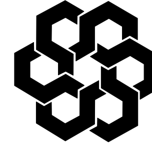

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International Accounting Standards Board

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:	**January 2009, London**
Project:	**IAS 39 Financial Instruments: Recognition and Measurement – Derecognition of Financial Assets**
Subject:	**Linked Presentation – Scope and Principle (Agenda Paper 2E-2)**

PURPOSE

1. Agenda Paper 2E-1 discusses whether the Linked Presentation model (LP) is appropriate for Flowchart 2.

2. The staff recommended that the Board adopts the LP model for Approach 2 to ameliorate the grossing-up of the statement of financial position resulting from that approach.

3. This paper discusses -

    a. **The Scope of the Linked Presentation** – Which transactions should an entity evaluate whether they meet the LP principle?

b. **The Linked Presentation Principle** – What principle should be used in determining when transactions, falling within the scope of LP, qualify for LP treatment?

SCOPE

4. The staff proposes that LP should be applied only to some of the assets that do not meet the proposed derecognition criteria in Flow Chart 2.

5. The LP model is a significant departure from current reporting requirements for financial assets and related liabilities. As such, the staff would look to a substantive difference in the nature of the asset or the associated liability, or both, to warrant this accounting treatment.

6. A transferor's exposure in a failed sale transaction tends to be of three types:

    a. the liability will be repaid only from proceeds generated by the specific asset it finances (or the transfer of the asset itself) and there is no possibility whatsoever of a claim on the entity being established other than against funds generated by that asset (or the asset itself); or

    b. the transferee has recourse for losses up to a fixed monetary ceiling (i.e. transferor's downside exposure is explicitly limited to a fixed, prefunded, monetary amount); or

    c. the transferor provides an open-ended guarantee (i.e. one that does not have a fixed monetary ceiling).

7. The staff believes that LP is appropriate only in type (a) and (b) arrangements. The staff also believes that allowing LP for only type (a) transactions would be too restrictive. The staff notes that it will be inappropriate to allow LP for type (c) arrangements as the transferor's exposure is no different from the general liabilities of the entity.

8. The staff therefore recommends that LP be limited to arrangements where the transferor's downside exposure is explicitly limited to a fixed, prefunded, monetary amount (i.e. type (b) arrangements).

9. The substantive difference between such items and the general assets and liabilities of the entity is that the transferor has no obligation to support the liabilities in excess of the assets transferred, unlike type (c) above.

10. This scope limitation meets the requirement that a liability that is to be linked to the asset should be fundamentally different from the general obligations/liabilities of the transferor.

11. The staff proposes that the LP treatment be extended to self liquidating non recourse loans should the Board decide that the accounting treatment for those transactions recommended by the staff at the December meeting not to be appropriate.

12. A self liquidating non-recourse finance arrangement is where the finance will be repaid only from the benefits generated by the specified item.

THE LINKED-PRESENTATION PRINCIPLE

13. The following are two alternative approaches to determining when a transferor should display a financial asset and the related liability linked. Alternative A is more ‘restrictive’ than Alternative ‘B’ (meaning that fewer liabilities would be linked to assets under Alternative A).

Alternative A (UK FRS 5 Approach)

> **<u>Linked presentation principle</u>**
>
> A transferor shall present a transferred asset that fails the practical ability to transfer criterion (and as such treated as secured borrowing), the associated liability and the net of the asset and liability, together if the arrangement ‘ring-fences’ the asset such that:
>
> (a) the finance will be repaid only from proceeds generated by the specific asset it finances (or by transfer of the item itself) and there is no possibility whatsoever of a claim on the entity being established other than against funds generated by that asset (or the asset itself),

(b) there is no provision whatsoever whereby the entity may either keep the asset on repayment of the finance or re-acquire it at any time and

(c) That the directors of the entity state explicitly in each set of financial statements where a linked presentation is used that the entity is not obliged to support any losses from the financial asset, nor does it intend to do so.

(d) The provider of the finance has agreed in writing (in the finance documentation or otherwise) that it will seek repayment of the finance, as to both principal and interest, only to the extent that sufficient funds are generated by the specific asset it has financed and that it will not seek recourse in any other form

(e) if the funds generated by the asset are insufficient to pay off the provider of the finance, this does not constitute an event of default for the entity.

14. Under this approach the conditions above are required to ensure there is no confusion as to the boundaries of the principle, to ascertain in what circumstances the principle is met and to ensure that the purpose of the principle is achieved.

15. Condition (a) requires that the finance relates to a specific item. A linked presentation should not be used where the finance relates to any kind of business unit, or for items that generate the funds required to repay the finance only by being used in conjunction with other assets of the entity. The item must generate the funds required to repay the finance either by unwinding directly into cash (as in the case of a debt), or by its sale to a third party.

16. Condition (a) also requires that there is no possibility whatsoever of a claim on the entity being established other than against funds generated by that asset (or the asset itself). Thus there must be no doubt whatsoever that the claim of the provider of the finance is limited strictly to funds generated by the specific item it finances.

17. Conditions (b) – (e) require that there is no recourse and no other condition that could result in the entity supporting losses, from whatever cause, on the items

being financed (or, as discussed in the next paragraph, supporting such losses beyond a fixed monetary ceiling).

18. Condition (b) – (e) ensures that it is clear that there is no legal, commercial or other obligation under which the entity may fund losses (from whatever cause) on the items being financed or transfer any economic benefits (apart from those generated by the item).

19. Under this approach the transfer arrangement should be such that the transferor would pass through the economic benefits of the asset to the transferee in satisfaction of the liability. The transferor should be looking only to those economic benefits for repayment.

20. However, a transaction might be such that the transferor would pass through the economic benefits of the transferred asset to the transferee but still not qualify for LP, if the transferor also agrees to provide additional assets in the future (e.g. a guarantee to support losses).

21. This alternative requires an assessment of both the assets transferred and the liabilities incurred and hence focuses on both the nature of the assets and the liabilities.

22. If all of the above conditions hold for only part of the finance, a linked presentation is used for only that part. In such cases, the maximum future payment that the entity could make (other than from funds generated by the specific item being financed) should be excluded from the amount deducted.

23. That is to say, if there is partial recourse for losses up to a fixed monetary ceiling, a linked presentation may still be appropriate in respect of that part of the finance for which there is no recourse. However, if the entity provides any kind of open-ended guarantee (i.e. one that does not have a fixed monetary ceiling) a linked presentation should not be used.

24. Alternative A may provide users of financial statements with a clear understanding of the allocation of the economic benefits arising from the financial assets between the transferor and the transferee and the economic relationship

between transferred financial assets that do not meet the criteria for derecognition and related obligations.

Alternative B

Linked presentation principle A transferor shall present a transferred asset that fails the practical ability to transfer criterion (and as such treated as secured borrowing), the associated liability and the net of the asset and liability together if the arrangement is such that: the transferor's downside exposure is explicitly limited to a fixed, prefunded, monetary amount (i.e. the transferee has recourse for losses up to a fixed monetary amount)

25. This alternative includes the total obligation of the transferor as part of the linked display. That is, the liability associated with the 'transferred assets' and any other obligations of the transferor related to the transaction are combined and deducted from the asset.

26. Alternative B seeks to identify and link assets that have a unique relationship with specific liabilities and thus separates such items from the other assets and liabilities of the entity. The unique relationship recognises that transferred assets less all related obligations could represent the entity's net economic exposure.

Staff Recommendation

27. The staff does not recommend Alternative A because the staff believes that that approach is too restrictive and hence only few cases will qualify for LP.

28. Most transfers involve other obligations that may cause the transferor to fail the derecognition criteria in Flow chart 2. Therefore, if the obligation must be settled only by the cash flows of the transferred financial asset, there will be very few transactions that will meet the LP principle.

29. The staff recommends Alternative B, as it is less restrictive but still sets a high threshold for qualification for LP. It is also consistent with the staff

recommendation under scope of LP (i.e. LP is only appropriate when the transferor's downside exposure is explicitly limited to a fixed, prefunded, monetary amount).

Question for the Board

30. Does the Board agree with the staff recommendation in paragraph 29? If not, why not?

31. If not, what do you suggest the LP principle should be, and why?