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This paper is a very early draft of part of the Conceptual Framework discussion paper. It has been prepared by the staff for discussion by the IASB. Issues discussed and conclusions reached will be subject to change.

Section 4
Recognition and derecognition

What does this section cover?

This section discusses:

- When should an entity's statement of financial position report a resource as an asset, or report an obligation as a liability? (recognition)
- When should an entity remove an asset or liability from its statement of financial position? (derecognition)

Why is this section important? What problems will this section help address?

This section:

- Updates the recognition criteria in the light of changes made to the qualitative characteristics.
- Introduces criteria for derecognition. The existing Conceptual Framework does not address derecognition.

What are the IASB's preliminary views?

- An entity should recognise all its assets and liabilities, except as follows.
- The IASB might decide in a in a project to develop or revise a particular standard that an entity need not, or should not, recognise an asset or liability if recognising the asset or liability would provide users with information that is

not relevant, or is not sufficiently relevant to justify the cost.

- When an entity transfers an asset or liability to another party, an important step in determining whether the entity still has that asset or liability is to determine whether that other party holds it as principal, or as agent for the transferor. The entity would continue to recognise an asset or liability that the other party (the transferee) holds as agent for the transferor.
- An entity should derecognise an asset or liability when it no longer meets the recognition criteria. However, if the entity still has some components of the asset or liability, the IASB should decide in projects to develop or revise particular standards how the entity would best portray the components it retains and the change in its assets and liabilities. The Conceptual Framework would provide some guidance for the IASB to consider when it makes those decisions.

Recognition

1. The existing Conceptual Framework defines recognition as follows:

> Recognition is the process of incorporating in the balance sheet or income statement an item that meets the definition of an element and satisfies the criteria for recognition set out in paragraph 4.38. It involves the depiction of the item in words and by a monetary amount and the inclusion of that amount in the balance sheet or income statement totals.[1]

2. In practice, questions about recognition (and derecognition) relate mainly to assets and liabilities. Answers to those questions affect the statement of financial position. They may also affect the timing for the recognition of income and expense in the statement of comprehensive income.

3. The recognition criteria in the existing framework state that an entity recognises an item that meets the definition of an element if:

   (a) it is probable that any future economic benefit associated with the item will flow to or from the entity; and

   (b) the item has a cost or value that can be measured with reliability.[2]

4. In addition, as with all other aspects of the existing Conceptual Framework, the cost constraint applies. Thus, if the IASB concludes for a particular standard that the benefits of recognising a particular asset or liability do not justify the costs,

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[1] 4.37

[2] 4.38

the IASB would not require its recognition (and to enhance comparability would perhaps prohibit its recognition).

Should an entity recognise all its assets and liabilities?

5. Part of the information that is useful to users for their decisions about providing resources to an entity is information about the entity's resources and obligations and about how efficiently and effectively the entity's management and governing board have discharged their responsibilities to use the entity's resources.[3] If all else is equal, the most understandable and concise way to provide a complete summary of an entity's resources and obligations is to recognise them all in the statement of financial position.

6. The failure to recognise items that qualify for recognition is not rectified by disclosure of the accounting policies used nor by notes or explanatory material.[4]

7. As noted above, the existing Conceptual Framework includes recognition criteria. As a result, existing standards do not require entities to recognise all their assets and liabilities. The following paragraphs discuss whether to include recognition criteria that refer to:

   (a) Probability (see paragraph 8)

   (b) Relevance and cost constraint (see paragraphs 9-11)

   (c) Faithful representation (see paragraphs 12-19)

   (d) Enhancing qualitative characteristics (comparability, verifiability, timeliness, understandability) (see paragraphs 20-21).

Probability

8. The existing criteria do not permit recognition if it is not probable that any future economic benefit associated with the item will flow to or from the entity. As explained in section 2, this [draft] discussion paper proposes that the IASB should delete references to probability from the recognition criteria in the Conceptual Framework.

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[3] OB2-OB4

[4] 4.37

Relevance and the cost constraint

9. Information is relevant to users if it is capable of making a difference in the decisions made by users.[5] In most cases, recognising rights and obligations provides users with relevant information, but in some cases it may provide information that is not relevant, or that is not sufficiently relevant to justify the cost:

   (a) If the level of uncertainty in an estimate is sufficiently large, that estimate will not be particularly relevant.[6] That would occur if users cannot depend on (rely on) that estimate to represent faithfully what it purports to represent, even with appropriate disclosure. Some argue that this is the case for some litigation, for at least some research and development projects and for internally generated goodwill.

   (b) Recognising particular rights and obligations may produce information that is not relevant or is not understandable if related rights and obligations are also not recognised. For example, some argue that relevant information does not result from recognising derivatives used to hedge normal purchases of commodities used in a production process if the underlying purchases have not yet been recognised.

   (c) In some cases, it may not be feasible, or may be too costly, to develop a current measure that represents faithfully the economic benefits an asset will produce, and a cost-based measure may have too little connection with the value of those economic benefits to provide relevant information. For example, some argue that measures of the economic benefits derived from knowledge gained in a research and development project are not feasible or are too costly to produce. They also argue that a cost-based measure of such knowledge may be irrelevant because it is likely to be incomplete and perhaps arbitrary, and because the value of a successful project may significantly exceed cost.

   (d) Currently, entities do not recognise internally generated goodwill, although they do recognise goodwill acquired in a business

[5] QC6

[6] QC16

combination. As explained in paragraphs BC313-BC323 of the *Basis for Conclusions* on IFRS 3 *Business Combinations*, goodwill meets the definition of an asset. That conclusion applies equally to internally-generated goodwill and to acquired goodwill. However, recognising internally-generated goodwill does not pass a cost-benefit test:

(i) Benefit: General purpose financial reports are not designed to show the value of a reporting entity; but they provide information to help existing and potential investors, lenders and other creditors to estimate the value of the reporting entity.[7] Thus, recognising internally-generated goodwill is not necessary to meet the objectives of financial statements and so provides little or no benefit. Moreover, a measure of internally-generated goodwill may not be relevant to users if the level of uncertainty in an estimate of that measure is sufficiently large that users cannot depend on (rely on) that measure to provide a faithful representation. In contrast, recognising goodwill in a business combination provides information that is relevant to users. It depicts more completely the economic resources acquired in the transaction for use by management, and the economic resources transferred to (or equity instruments delivered to) the vendors.

(ii) Cost: Measuring internally-generated goodwill would be costly. In contrast, measuring goodwill acquired in a business combination as a residual at a single date is not costly, although some cost is involved in carrying out subsequent impairment tests of the goodwill.

(e) Similarly, measuring some internally-generated intangible assets may not pass a cost-benefit test if the resulting measures are not relevant to users, or if identifying those assets and measuring them is too costly.

10. This paper concludes that the IASB should not require recognition of an asset or liability if, in the IASB's view, recognition would result in information that is not relevant, or not sufficiently relevant to justify the cost of preparing it.

[7] OB7

11. The Conceptual Framework is not a standard, and does not override standards. Therefore, when a standard requires recognition of an asset or liability, a preparer could not use the recognition criteria in the Framework to override that requirement.

Faithful representation

12. The recognition criteria in the existing Conceptual Framework state that an entity recognises an asset or liability only if it has a cost or value that can be measured with reliability. Before its revision in 2010, the Conceptual Framework stated that information is reliable if it is free from material error and bias, and users can depend on it to represent faithfully what it either purports to represent or could reasonably be expected to represent. That version of the Conceptual Framework explained that, to be reliable, information must:

    (a) account for, and present, transactions in accordance with their substance and economic reality and not merely their legal form.[8]

    (b) be neutral, that is, free from bias.[9] The Conceptual Framework also argued, under the heading of prudence, for a degree of caution in the exercise of the judgements needed in making the estimates required under conditions of uncertainty, such that assets or income are not overstated and liabilities or expenses are not understated.[10]

    (c) be complete within the bounds of materiality and cost.[11]

13. The term *reliability* no longer appears in the Conceptual Framework, though much of the content of that concept is covered by the current Conceptual Framework's fundamental characteristic of faithful representation and its enhancing characteristic of verifiability. Paragraphs BC3.23-24 of the *Basis for Conclusions* on the *Conceptual Framework* explain that:

    (a) the comments of respondents to numerous proposed standards indicated a lack of a common understanding of the term *reliability*. Some

[8] Former framework, paragraph 35

[9] Former framework, paragraph 36

[10] Former framework, paragraph 37

[11] Former framework, paragraph 38

focused on *verifiability* or *free from material error* to the virtual exclusion of faithful representation. Others focused more on faithful representation, perhaps combined with neutrality. Some apparently thought that reliability referred primarily to precision.

(b) the term *faithful representation* encompasses the main characteristics that the previous framework included as aspects of reliability.

14. A perfectly faithful representation would be complete, neutral and free from error.[12] Of course, perfection is seldom, if ever, achievable. The IASB's objective is to achieve as faithful a representation as possible:

(a) Completeness suggests that, if all else is equal, an entity should recognise all its resources and obligations.

(b) Neutrality suggests that, if all else is equal, the recognition criteria should apply symmetrically to resources and to obligations, and that the criteria should apply symmetrically, regardless of whether a transaction or other event that leads to recognition results in a gain, a loss or no gain and no loss.

(c) Freedom from error suggests that, if all else is equal, an entity should not recognise an asset or liability if either the process of determining whether to recognise that asset or liability, or its measurement, is likely to be unduly prone to error. In such cases, recognising the asset or liability may not result in relevant information.

15. Because the Conceptual Framework no longer defines or describes reliability, the recognition criteria cannot retain that term. The following discussion considers whether the recognition criteria should include anything corresponding to the previous reference to reliability, or to any other aspect of faithful representation.

16. Under the existing recognition criteria, questions about reliability of measurement arise if measurement uses significant estimates. The existing Conceptual Framework states that an estimate "can be a faithful representation if the reporting entity has properly applied an appropriate process, properly described the estimate and explained any uncertainties that significantly affect the estimate. However, if

[12] QC12

the level of uncertainty in such an estimate is sufficiently large, that estimate will not be particularly useful. In other words, the relevance of the asset being faithfully represented is questionable. If there is no alternative representation that is more faithful, that estimate may provide the best available information."[13]

17. It follows that if a measure of an asset or liability depends on estimates, the questions relating to recognition are:

    (a) Would that measure provide relevant information to users? If not, would some other measure provide relevant information? If no available measure would provide relevant information, the approach in paragraph 10 suggests the entity should not recognise the asset or liability.

    (b) If a measure of an asset or liability would provide relevant information to users, what is the most faithful way to represent that asset or liability:

        (i) by recognising it (with supporting disclosure, if needed)?

        (ii) or by not recognising it (with supporting disclosure, if needed)?

18. As noted in paragraph 10, this [draft] discussion paper concludes that the IASB should not require recognition of an asset or liability if, in the IASB's view, recognition would result in information that is not relevant. The IASB has identified no circumstances when recognising an asset or liability would provide information that is relevant, but does not result in a faithful representation of that asset or liability and about changes in that asset or liability. Accordingly, there is no need for the recognition criteria to refer to faithful representation.

19. In considering how to represent faithfully its recognised assets and recognised liabilities, an entity would need to consider which measurement to use, how to present the asset or liability and what disclosures to provide about it. Sections 5-7 of this paper discuss these issues.

[13] QC16

Enhancing characteristics

20. The usefulness of financial information is enhanced if it is comparable, verifiable, timely and understandable.[14] What implications might that have for decisions about recognition?

    (a) If all else is equal, failure to recognise some of an entity's assets or liabilities is likely to make the entity's financial statements less comparable and understandable, and to provide less timely information to users.

    (b) Verifiability means that different knowledgeable and independent observers could reach consensus, although not necessarily complete agreement, that a particular depiction is a faithful representation. Quantified information need not be a single point estimate to be verifiable. A range of possible amounts and the related probabilities can also be verified.[15] As noted in paragraph 16, if the level of uncertainty in an estimate is sufficiently large, that estimate will not be particularly useful. In other words, lack of verifiability may, in some cases, make information less relevant. This [draft] discussion paper identifies no further role for verifiability in decisions about recognition.

    (c) On occasions, recognising a resource or obligation might make the statement of financial position less understandable if it is closely linked to another resource or obligation that is unrecognised.

21. This [draft] Discussion Paper does not propose recognition criteria relating to the enhancing characteristics of comparability, verifiability, timeliness and understandability.

Summary of proposed recognition criteria

22. Except as discussed below, an entity should recognise all its assets and liabilities. The failure to recognise an asset or liability is not rectified by disclosure of the accounting policies used nor by notes or explanatory material.[16] The resulting

[14] QC4

[15] QC26

[16] 4.37

depiction of the entity's resources and obligations would be incomplete, and thus not provide a fully faithful representation of the entity's financial position.

23. This [draft] discussion paper proposes that the IASB might decide in a standards-level project that an entity need not, or should not, recognise an asset or liability if recognising the asset (or liability) would provide users with information that is not relevant, or not sufficiently relevant to justify the cost.

24. The following are some indicators that recognition might not be appropriate:

    (a) If a resource (or obligation) exists, but there is only a low probability that an inflow (or outflow) of economic benefits will result. In some such cases, the IASB might conclude that users would not factor information about that inflow (or outflow) directly into their valuation models. Moreover, in some cases where there is only a low probability of an inflow (or outflow), measures of the resource or obligation may be exceptionally sensitive to small changes in the estimate of the probability. In those cases, it may be difficult to depend on (rely on) a measure of the resource or obligation to provide a faithful representation, even when supplemented by disclosure.

    (b) If the range of possible outcomes is extremely wide and the likelihood of each outcome is exceptionally difficult to estimate. (As an example, this might be the case for major litigation.[17]) In such cases, the most relevant information for users might relate to the range of outcomes and the factors affecting their likelihoods. When such information is relevant (and can be provided at a cost that does not exceed the benefits), the entity should disclose that information, regardless of whether the entity also recognises the asset or liability. Trying to capture that information in a single number as a measure for recognition in the statement of financial position may not provide any further value to users.

    (c) If identifying the resource or obligation is unusually difficult. As an example, this may be the case for some intangible assets, particularly

[17] Litigation may also be subject to existence uncertainty, as discussed in section 2 of this paper.

some of those generated internally rather than acquired in a separate transaction.

(d) If measuring a resource or obligation requires unusually difficult or exceptionally subjective allocations of cash flows that do not relate solely to the item being measured.

(e) If recognising an asset is not necessary to meet the objectives of financial statements. As noted in paragraph 9(d), this is the case for internally-generated goodwill.

25. If an entity has an asset or liability but does not recognise it, disclosure may be needed, including perhaps disclosure about the factors that prevent recognition.

Derecognition

26. The IASB *Glossary of terms* defines derecognition as the removal of a previously recognised item from an entity's statement of financial position.

27. The existing Conceptual Framework does not define derecognition and does not describe when derecognition should occur. Because there is no agreed conceptual approach to derecognition, different standards have adopted different approaches. This risks causing inconsistency, with the further risk of adopting rules-based approaches rather than principles-based approaches.

28. The rest of this sub-section deals with the following:

(a) Consequences of derecognition (paragraphs 29-31)

(b) Objective of derecognition (paragraph 32)

(c) Control approach or risks and rewards approach? (paragraphs 33-41)

(d) Full or partial derecognition? (paragraphs 42-44)

(e) Summary of proposed derecognition criteria (paragraphs 45-46)

Consequences of derecognition

29. Derecognition has the following consequences:

(a) The entity no longer recognises the previously recognised asset or liability.

(b) The entity may need to recognise other assets and liabilities that result from the transaction or other event that gave rise to the derecognition.

(c) Income or expense may arise from the derecognition of the previous asset or liability and the recognition of any new asset or liability.

30. As noted in section 2 [Elements of financial statements], many economic resources comprise a bundle of rights. An entity would recognise, measure and present some of these rights separately if such separation results in the most relevant information, and if the benefits of separation outweigh the costs. Similarly, when an entity transfers some rights associated with a resource and retains others, it would derecognise the rights that it no longer controls and continue to recognise the rights retained. For example, a lessor derecognises the right of use granted to the lessee and continues to recognise the remaining rights associated with the underlying leased item. Paragraphs 42-44 discuss in more detail how an entity should account for the rights it retains in such cases.

31. When an asset or liability is transferred between entities within a consolidated group (a parent and its subsidiaries), the asset or liability is still an asset or liability of the group as a whole. Accordingly, in consolidated financial statements, the group continues to recognise the asset or liability.

Objective of derecognition

32. The aim of accounting requirements for a transaction that may result in derecognition should be to represent faithfully both:

(a) the resources and obligations remaining after the transaction, and

(b) the changes in the resources and obligations as a result of a transaction.

Control approach or risks and rewards approach?

33. Achieving that twin aim is straightforward if an entity disposes of an entire asset or entire liability. In that case, derecognition represents faithfully both the absence of rights and obligations relating to that item, and the elimination of all the previous rights or obligations. Similarly, if an entity disposes of a proportion (say 30%) of an asset, derecognition of that 30% will represent faithfully that the entity retains 70% of the asset and disposed of 30% of it.

34. However, achieving that twin aim is more difficult if the entity retains a component that exposes the entity disproportionately to the remaining risks or rewards arising from the previously recognised asset or liability. There are two approaches to derecognition in such cases:

    (a) A control approach: derecognition is simply the mirror image of recognition. Thus, an entity would derecognise an asset or liability when it no longer meets the criteria for recognition. This implies that the derecognition criteria for an asset would focus on control of the asset (rather than on legal ownership or on risks and rewards) and the derecognition criteria for a liability would focus on whether the entity has the liability.

    (b) A risk and rewards approach: an entity should continue to recognise an asset or liability until it is no longer exposed to most of the risks and rewards generated by the asset or liability, even if the remaining asset or (liability) would not meet the recognition criteria if acquired (or incurred) separately at the date when the entity disposed of the other components. Thus, whether an entity recognises an asset or liability depends, in some circumstances, on whether the entity previously recognised that asset or liability. As a result, some use the labels ‘history matters’ or ‘stickiness’ for a risk and rewards approach.

35. Proponents of a control approach argue that it treats identical rights or obligations in the same way, regardless of whether they were recognised previously. Proponents of a risks and rewards approach focus on cases such as the following, where they believe that derecognition would not represent faithfully the change in circumstances:

    (a) a material reduction in recognised assets or liabilities with no significant decrease in the risks borne by the entity. An example is when an entity transfers a receivable but guarantees the purchaser against some or most of the future loan losses arising from that asset (see example A).

    (b) material revenue, or a material gain, that arises on delivering an asset that may or must be returned to the vendor through means such as a

forward contract (see example B), written put option, purchased call option or lease.

36. Example A illustrates a case where an entity sells an asset but retains some of the risk through a guarantee.

Example A: Sale of receivables with partial recourse

Fact pattern

Entity A controls receivables with a carrying amount of CU1,000[18] and a fair value of CU1,000. It sells the receivables to Bank B for cash of CU1,050. Entity A guarantees Bank B against any losses that Bank B suffers above CU140. The fair value of the guarantee is CU50.

Applying a control approach

Under a control approach, Entity A would first assess whether Bank B is holding the receivables as agent for Entity A. If Bank B is holding the receivables as agent, Entity A would continue to recognise the receivables measured at CU1,000. Entity A would also recognise cash of CU1,050 and a deposit liability of CU1,050.

If Entity A concludes that Bank B is holding the receivables as principal, not as agent, Entity A would derecognise the receivables, recognising cash of CU1,050 and a guarantee liability of CU50. Entity A reports the guarantee liability in the same way as if it had issued a stand-alone guarantee of loans that it had never previously controlled.

Applying a risks and rewards approach

Under a risks and rewards approach, Entity A would continue to recognise the receivables at CU1,000, and would recognise cash of CU1,050 and a deposit liability of CU1,050. Measuring the receivables at CU1,000 depicts the fact that Entity A is still exposed to some (though in this example not all) of the credit risk arising from the receivables.

37. Example B illustrates a sale combined with a repurchase.

[18] In this [draft] discussion paper, currency amounts are denominated in “currency units” (CU).

Example B: Sale of a bond with repurchase agreement

Fact pattern

Entity A controls a quoted zero coupon bond with a carrying amount of CU800 (amortised cost, with an effective interest rate of 5%) and a fair value of CU1,000 (reflecting a market interest rate of 4%). It sells the bond to Bank B for cash of CU1,000, and contracts to buy back the bond for CU1,045 after 12 months (the difference of CU45 reflects market interest rates today for a loan secured by such a bond). Assume that the fair value of Entity A's commitment to repurchase the bond is nil.

Applying a control approach

Under a control approach, Entity A would first assess whether Bank B is holding the bond as agent for Entity A. If Entity A is acting as agent, it would conclude that it retains control of the bond, and Entity A would:

- continue to recognise the bond at CU800, both before and after the repurchase (and would accrue interest on the loan at 5%).
- recognise cash of CU1,000.
- recognise as a liability a loan of CU1,000, repayable in 12 months with interest at 4.5%.

If Entity A concludes that Bank B holds the bond as principal, not as agent, it would derecognise the bond, recognising:

- cash of CU1,000
- a repurchase obligation: a loan commitment liability, measured at nil in this fact pattern
- a gain of CU200.

On repurchasing the bond, Entity A would recognise the bond and measure it at CU1,045. It would derecognise the loan commitment liability.

> The control approach reports assets and liabilities that are comparable with those that Entity A would have reported for a stand-alone forward contract to buy the bond for CU1,045 in 12 months.
>
> *Applying a risks and rewards approach*
>
> Under a risks and rewards approach, Entity A would account for the bond in the same way as if it concluded that Bank B holds the bond as agent.
>
> Arguably, when Entity A concludes that Bank B is holding the bond as principal, the risks and rewards approach portrays more clearly than the control approach the fact that that the transaction had virtually no effect on the amount, timing and uncertainty of the entity's cash flows, other than receiving cash of CU1,000 and repaying it a year later with interest.

38. As examples A and B illustrate, there are two main sources of concerns in decisions about derecognition:

    (a) In some cases, derecognition results in smaller numbers on the balance sheet, even though the entity is still exposed to risks of similar magnitude. In example A, derecognition would mean that Entity A no longer recognises its receivables (previously carried at CU1,000) even though it is still exposed to a considerable part of the credit risk arising from those receivables. Entity A would need to communicate that risk by appropriate presentation and disclosure of the risk retained through the guarantee measured at the lower amount of CU50.

    (b) In some cases, derecognition results in the recognition of a gain that would not arise if the entity treated the sale proceeds as a financing transaction. In example B, Entity recognises a gain if it derecognises the bond, and it subsequently measures the reacquired bond at an amount greater than its original cost.

39. Continuing recognition would not be the only possible solution to the concerns that examples A and B illustrate. Paragraphs 40 and 41 discuss other possible solutions.

40. The concern in example A arises because derivatives are more highly leveraged than cash instruments, such as loans. Said differently, they expose entities to more concentrated risks than cash instruments do. One solution would be to change the accounting for all derivatives to show that extra leverage more directly. For instance, in example A, the issuer of such a guarantee might report receivables of CU1,000 and a deposit liability of CU1,050, rather than just a guarantee liability of CU50. If that treatment applied to all guarantees, not just those retained in a transfer, that would eliminate the pressure for continuing recognition in example A. However, it is not clear that the receivable reported under such an approach would meet the definition of an asset.

41. The concern in example B arises when a sale and repurchase agreement could be used to recognise a gain (or perhaps a loss) that would not arise if the entity continued to hold the asset or liability. That could occur when assets or liabilities are measured on a basis that differs from the price for which they could be transferred to another party. One solution to that concern would to measure all assets and liabilities at fair value (or perhaps fair value less costs to sell). However, as explained in section 6 [Measurement], the IASB's preliminary view is that measuring all assets and liabilities on that basis would not provide users with the most relevant information.

Full or partial derecognition?

42. When a transaction eliminates some but not all of the rights and obligations contained in an asset (or liability), two approaches might be considered for the rights and obligations retained:

    (a) Full derecognition: derecognise the entire asset (or liability) and recognise the retained component as a new asset (or liability). If the carrying amount of the retained component differs from its previous carrying amount, a gain or loss will arise on that component.

    (b) Partial derecognition: Continue to recognise the retained component and derecognise the component not retained.

43. The following are two examples where this question arises:

(a) When the terms of existing rights or obligations are changed by, for example, an agreement between two parties to amend a contract or by a change in the law. The modification may eliminate some of the existing rights or obligations and it may create new rights or obligations.

(b) In a sale and leaseback transaction, as illustrated in example C.

Example C: Sale and leaseback

Fact pattern

Entity A controls a machine that has a remaining useful life of 10 years and a carrying amount of CU800. Entity A sells the machine to Lessor B for its fair value of CU1,000, and simultaneously Lessor B leases the machine back to Entity A for the first 6 years for lease rentals at a current market rate and with a present value of CU600.

Applying a full derecognition approach

If Entity A derecognises the entire machine, it will:

- Recognise a new asset: the right to use the machine for years 1-6, measured at CU600
- Recognise the lease obligation, measured at CU600
- Recognise cash of CU1,000
- Recognise a gain of CU200 on disposal of the machine.

Applying a partial derecognition approach

If Entity A derecognises only part of the machine, it will:

- Continue to recognise the retained component of the asset: the right to use the machine for years 1-6. For this example, assume that the retained component is measured at CU480 = CU800 x (6/10).
- Derecognise the right to use the machine from years 7-10, recognising a gain of CU80 = (CU1,000 – CU800) x (4/10).
- Recognise cash of CU1,000

- Recognise a loan received, measured at CU600.

44. In example C, the full and partial derecognition approaches result in different measures of the retained component. In addition, the full derecognition approach may result in the recognition of a gain or loss on the retained component. In contrast, the partial derecognition approach does not (though the entity would generally need to test the retained component for impairment). It is likely to be a standards-level decision to determine whether to apply a full derecognition approach or a partial derecognition approach, because that decision depends on the unit of account.

Summary of proposed derecognition criteria

45. The derecognition criteria need to reflect how best to portray both an entity's rights and obligations, and changes in those rights and obligations. In most cases, an entity will achieve this by derecognising an asset or liability when it no longer meets the recognition criteria. However, if the entity retains a component of the asset or liability, the IASB should determine in projects to develop or amend particular standards how the entity would best portray the changes that resulted from the transaction. Possible approaches include:

    (a) Enhanced disclosure.

    (b) Presenting any rights or obligations retained on a line item different from the line item used for the original rights or obligations, to highlight the greater concentration of risk.

    (c) Continuing to recognise the original asset or liability, and treating the proceeds received or paid for the transfer as a loan received or granted.

46. It would be a decision for particular standards, depending on the unit of account, to determine which of the following approaches to use when an entity transfers components of an asset or liability to another party, or modifies the terms of an asset or liability:

    (a) Full derecognition approach: derecognise the entire asset or liability and recognise a new asset or liability.

(b) Partial derecognition approach: continue to recognise the components retained.

Questions for respondents

47. Do you agree that the Conceptual Framework should state that:

    (a) an entity should recognise all its assets and liabilities, except as follows?

    (b) the IASB might decide in a project to develop or revise a particular standard that an entity need not, or should not, recognise an asset or liability if recognising the asset (or liability) would provide users with information that is not relevant, or is not sufficiently relevant to justify the cost?

    (c) when an entity transfers an asset or liability to another party, an important step in determining whether the entity still has that asset or liability is to determine whether that other party holds it as principal, or as agent for the transferor? The entity would continue to recognise an asset or liability that the other party (the transferee) holds as agent for the transferor.

    (d) an entity should derecognise an asset or liability when it no longer meets the recognition criteria? However, if the entity retains a component of an asset or liability, the IASB should determine in projects to develop or revise particular standards how the entity would best portray the changes that resulted from the transaction.

48. Do you have any other comments on the proposed approaches to recognition and derecognition?