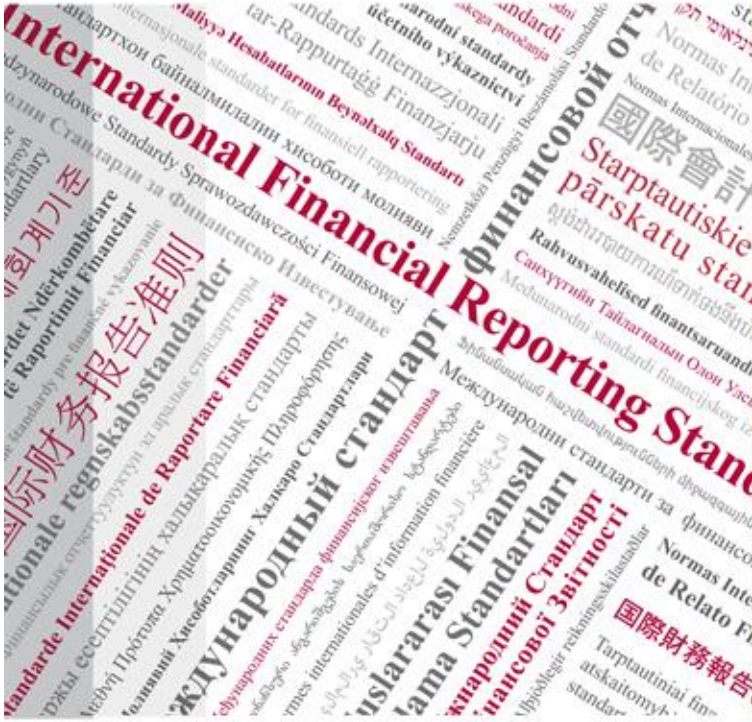
International Financial Reporting Standards



Conceptual Framework: Recognition/ Derecognition

Agenda paper 9C

Education Session – January 2013

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Existing guidance

- Recognition criteria:
  - Meets **definition**
  - **Probable** that future economic benefits will flow to/from the entity
  - Cost or value can be **measured reliably** (complete, neutral and free from error)
- **No** derecognition criteria
  - But IAS 39/IFRS 9 and Revenue Recognition include some guidance

Recognition

Existing criteria - Probable

- Problem: Does reference to probability refer to:
  - – Probability the element exists (eg a law suit)
  - – Probability of outcome (eg lottery ticket)
  - – Both?

Uncertainty of existence	Uncertainty of outcome
Retain probability threshold • Probable? Virtually certain?	3 possible approaches (see next slide)

Outcome uncertainty

Approach	Comments
1) Do not include probability threshold for outcome uncertainty	Even if there is no threshold, elements with a low probability of occurring: • may not be recognised for other reasons eg relevance; or • may be measured at zero (if measured at most likely amount)
2) Retain a probability threshold to filter out outcomes with a low probability of occurring	Some think that users will not factor low probability outcomes into their valuation
3) Do not recognise element if there is a wide range of outcomes and the probabilities of the different outcomes are unknown and arguably unknowable	Measures derived from estimates of these probabilities may be neither relevant nor verifiable (eg a highly speculative R&D project or some litigation)

Existing criteria - Reliability

- Problem:
  - Unclear when an element can be measured reliably
  - May create too high a barrier to recognition
  - Inconsistent application
- Examples:
  - IFRS 9 vs IAS 37
  - Purchased vs Internally generated goodwill and intangibles

Existing criteria - Control

- Problem:
  – Whether an entity controls an asset is part of the definition of an asset
  – Control of an asset identifies who the asset belongs to so may be better viewed as a recognition criterion
- Need to consider definition of control:

Control of an asset (revenue recognition)	Control of an investee (IFRS 10)
The ability to direct the use of and obtain substantially all of the remaining benefits from the asset. Control includes the ability to prevent other entities from directing the use of and obtaining the benefits from an asset.	An investor controls an investee when the investor is exposed, or has rights, to variable returns from its involvement with the investee and has the ability to affect those returns through its power over the investee.

Proposals for recognition

- Create a presumption that an entity should recognise all assets it controls, and liabilities that bind it
- Provide guidance about when an entity would not recognise an asset or liability because of uncertainty over its existence
- Provide indicators of when it may be better not to recognise an asset or liability

Indicators

- Indicators when it may be better not to recognise an asset or liability:
  - if recognising the asset or liability may not provide relevant information (eg if very low probability events, or perhaps if recognition would result in an accounting mismatch)
  - if no measurement of the asset or liability would provide a sufficiently faithful representation (eg range of outcomes extremely wide and probability of each outcome is unusually difficult to estimate)
  - if cost to measure outweighs benefits of measuring the asset/liability

Proposed recognition criteria

An entity should recognise an asset if, and only if, it controls that asset.

An entity should recognise a liability if, and only if, that liability binds the entity.

Derecognition

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Issue to consider

- Is derecognition the mirror image of recognition or does history matter?
- Mirror image
  – when lose control of the asset or entity is no longer bound by the liability, derecognise the asset/liability
- History matters = stickiness
  – Some previously recognised assets and liabilities continue to be recognised even though they no longer meet the definition of an asset or liability or meet the recognition criteria

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Example

Entity A transfers an asset with a carrying amount of CU70 to Entity B for its fair value (CU100). At the same time, Entity A agrees to repurchase that asset for CU100 in 1 year.
(For simplicity, ignore time value of money)

Balance sheet

Mirror image

Cash	100		
Repo	0		
	Gain	30	

History matters

Asset	70	
Cash	100	
	Liability 100	

However, if entity A had never owned the asset but entered into a forward purchase contract with entity B, it would simple recognise the forward contract

Proposals for derecognition

Derecognition is the mirror image of recognition but consider allowing an entity to continue to recognise assets or liabilities if derecognition would not faithfully represent the transaction.

- Reasons why mirror image is default
  - Consistent with recognition criteria
  - Same accounting treatment, irrespective of sequence
- Continued recognition
  - Standards-level issue
  - Consider both the financial position and transaction

Proposals for derecognition contd.

- Other issues to consider:
  - Better disclosures
    - Role of derecognition
  - Alternative presentations:
    - Linked presentation?
    - Gross up of all forwards and options?
    - Separate presentation of assets with different risk profiles

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