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STAFF PAPER

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Project	**Conceptual Framework**		
Paper topic	Feedback summary—Derecognition		
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Purpose of paper

1. This paper summarises the feedback received on the discussion of derecognition in the Exposure Draft *Conceptual Framework for Financial Reporting* ('the Exposure Draft').

2. This paper provides a high level summary of the comments received. Where appropriate, we will provide a more detailed breakdown of the comments for future meetings.

Exposure Draft proposals (paragraphs 5.25–5.36 and BC5.49–BC5.59)

3. The Exposure Draft described derecognition as follows:

> Derecognition is the removal of all or part of a previously recognised asset or liability from an entity's statement of financial position. For an asset, this normally occurs when the entity loses control of all or part of the previously recognised asset; for a liability this normally occurs when the entity no longer has a present obligation for all or part of the previously recognised liability.

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4. The Exposure Draft stated that:

   (a) Accounting requirements for derecognition aim to represent faithfully both:

      (i) the assets and liabilities retained after the transaction or other event that led to the derecognition (including any asset or liability acquired, incurred or created as part of the transaction or other event); and

      (ii) the change in the entity's assets and liabilities as a result of that transaction or other event.

   (b) The aims mentioned in (a) are normally achieved by:

      (i) derecognising any assets or liabilities that have been transferred, consumed, collected or fulfilled, or have expired and recognising any resulting income or expense; and

      (ii) continuing to recognise the assets or liabilities retained, if any, which become a separate unit of account.

   (c) If an entity transfers a previously recognised asset or liability to another party that is acting as its agent, then the asset is still controlled by the transferor (the liability is still an obligation of the transferor) and derecognition would not faithfully represent the transferor's assets, liabilities, income and expenses.

   (d) If an entity retains exposure to positive or negative variations in the amount of economic benefits produced by an economic resource, this may indicate that the entity retains control of that economic resource, in which case, derecognition is not appropriate.

   (e) It may sometimes be difficult to achieve both aims mentioned in (a):

      (i) in some cases derecognition may achieve the aims mentioned in (a) if supported by separate presentation, or explanatory disclosure, in the notes to the financial statements; and

      (ii) in other cases there may be a need to continue to recognise not only the retained component, but also the transferred component.

5. The Basis for Conclusions on the Exposure Draft explained that:
   (a) there are two approaches to derecognition when an entity retains a component of the asset or a liability, namely the control approach and the risks-and-rewards approach;
   (b) the control approach focuses more on the aim mentioned in paragraph 4(a)(i) of this paper and the risks-and-rewards approach focuses more on the aim mentioned in paragraph 4(a)(ii) of this paper; and
   (c) both aims are valid and, accordingly, the Board will not advocate using either the control approach or the risks-and-rewards approach in all circumstances. Instead the Exposure Draft described the alternatives available and discussed the factors the Board would need to consider when developing particular IFRS Standards.
6. The Exposure Draft also proposed guidance on how to account for modifications of contracts. In particular, the Exposure Draft stated that the accounting may differ depending on whether the rights and obligations that are added by a modification of a contract are distinct from those created by the original terms of the contract.

Summary of feedback

Derecognition

7. The invitation to comment on the Exposure Draft asked if respondents agreed with the proposed discussion on derecognition (Question 7). Approximately one half of respondents to the Exposure Draft commented on this question.
8. Many of those who responded to Question 7 stated that they generally agreed with the proposed discussion on derecognition. Some respondents did not necessarily disagree with the discussion in the Exposure Draft but suggested more work to be done. For example, one of these respondents, an accountancy body, asked for more conceptual guidance on how the Board will approach derecognition of assets and liabilities in the future. Some respondents questioned how the proposals would help the Board in developing and revising IFRS Standards and preparers in applying these Standards.

9. A few respondents stated that the Exposure Draft should explicitly discuss the control approach and the risks-and-rewards approach in the main text (rather than just in the Basis for Conclusions). One accountancy body stated that the Board should decide on one approach but did not indicate which approach it preferred. Some respondents stated that Board should include a discussion on how to choose between the two approaches.

10. A few respondents stated that the Board should adopt the risks-and-rewards approach to derecognition because the control approach is inappropriate for the derecognition of financial assets.

11. However, one quarter of those who responded to this issue stated that the Board should adopt the control approach to derecognition (without the transfer of risks and rewards being an indicator of control). Many of these respondents stated that derecognition should simply mirror recognition. One standard-setter supported the control approach to derecognition because it viewed it to be more consistent with the element definitions than other possible approaches.

12. A few respondents stated that if derecognition were to mirror recognition, a section on derecognition may not be necessary. A few other respondents stated that the Board must develop more robust concepts on recognition if derecognition were to mirror recognition.

13. A few respondents stated that, although it may be logical to have symmetry in recognition and derecognition, a separate discussion of derecognition is needed from a practical point of view.

14. Some respondents stated that the control approach should be adopted, with the transfer of risks and rewards being an indicator of control.

15. Some respondents stated that any choice between the control approach and the risks-and-rewards approach should be made based on the concepts of ‘substance over form’ and ‘faithful representation’. One standard-setter suggested that the discussion on derecognition should also refer to relevance, which is included as a criterion for recognition.

16. One standard-setter suggested that, similar to prohibiting an entity from recognising items that do not meet the element definition and recognition criteria, the *Conceptual*

Framework for Financial Reporting (‘the *Conceptual Framework*’) should prohibit an entity from derecognising items that do not meet the derecognition criteria.

17. A few respondents explicitly agreed with the statement in the Basis for Conclusions on the Exposure Draft that derecognition is closely linked to the determination of the unit of account and that detailed provisions regarding full or partial derecognition can only be discussed at the Standards level. However, a few respondents stated that the *Conceptual Framework* should include some general guideline on when partial derecognition or full derecognition would be appropriate. Some other respondents suggested that the *Conceptual Framework* include more detail, for example, on the approaches to partial derecognition and the accounting for any retained interest. A few respondents stated that the discussion regarding full or partial derecognition was confusing because if referred to a component of an asset, when an asset is described as a bundle of rights.

18. Some respondents asked the Board to clarify the effects of the proposed derecognition guidance on the following items:

    (a) derecognition of financial assets;

    (b) step-down transactions (ie when an entity reduces its holding in a subsidiary so that it has only significant influence or a simple equity interest); and

    (c) the control model under IFRIC 12 *Service Concession Agreements*.

19. Other comments included the following:

    (a) a few respondents stated that the level of detail was too high for a *Conceptual Framework* and the amount of guidance should be reduced;

    (b) a few respondents welcomed the discussion of principal versus agent in this Chapter, and one of those respondents, an accounting firm, suggested that the *Conceptual Framework* address how to determine when an entity is acting as principal versus agent in this context; and

    (c) one standard-setter stated that the proposals on derecognition are underdeveloped and suggested that further work be undertaken in a separate project.

Modification of contracts

20. Some respondents supported including the proposed guidance on modification of contracts. One standard-setter questioned whether the discussion of modification of contracts was helpful. One accounting firm suggested that this part be shortened.

21. A few respondents suggested that the concepts of 'substance over form' and 'unit of account' be included in the discussion of modification of contracts.

22. One accounting firm stated that modification of contacts should be discussed in a separate section because modifications may give rise to recognition as well as derecognition.

23. Some respondents raised the following concerns regarding the 'distinct' concept in the context of modification of contracts:

    (a) the term 'distinct' is not defined;

    (b) the term seems to be used more broadly than how it is used in existing IFRS Standards;

    (c) it is unclear whether the term has the same meaning as that proposed in the 2013 revised Exposure Draft on *Insurance Contracts*; and

    (d) the notion of 'distinct' may be helpful for contracts relating to non-financial items but not for financial items.