



5 August 2009

International Accounting Standards Board
1st Floor 30 Cannon Street
London EC4M 6XH
United Kingdom

(By online submission)

Dear Sir

RESPONSE TO EXPOSURE DRAFT ON DERECOGNITION (PROPOSED AMENDMENTS TO IAS 39 AND IFRS 7)

The Accounting Standards Council (ASC) appreciates the opportunity to comment on the Exposure Draft ED/2009/3 – ‘Derecognition’ – Proposed Amendments to IAS 39 and IFRS 7(ED) issued by the International Accounting Standards Board (IASB) in April 2009.

2. We do not agree with the proposals captured in this ED even though we understand the proposed amendments aim to simplify the process of derecognition of financial assets. The following comments are expressed specifically on the points raised on the assumption that the IASB will proceed and issue the IFRS in much the same form as the ED. Our key concerns of the ED are as follows:

a) Whether substantial changes should be implemented on a fast-track timetable. We are aware that the Board recommends proceeding directly from “research agenda” to “exposure draft” in response to the global financial crisis as well as recommendations from the Financial Stability Forum (FSF). Although we agree that concerns raised by the FSF and others should be addressed immediately, we suggest IASB should address for the near term on crisis-related amendments by improving relevant accounting and disclosure requirements. The process of redeveloping a new model for derecognition should go through a more thorough and thoughtful due process, instead of a “quick-fix” solution.

b) We do not agree that the existing “risks and rewards” tests should be removed completely and replaced by a “control” test. We are not convinced that derecognition criteria should be focused on single concept of control. We understand “control” will promote consistency; however, it is a prescriptive and legalistic approach. Focusing on a single concept of control will bring the accounting away from reflecting the real economic substance of transactions and will be at the expense of faithful representation of financial statements.

Our comments on the specific questions to the exposure draft are as follows:

Question 1—Assessment of ‘the Asset’ and ‘continuing involvement’ at reporting entity

level

Do you agree that the determination of the item (i.e. the Asset) to be evaluated for derecognition and the assessment of continuing involvement should be made at the level of the reporting entity (see paragraphs 15A, AG37A and AG47A)? If not, why? What would you propose instead, and why?

3. Yes, we agree that the determination of the item to be evaluated for derecognition and the assessment of continuing involvement should be made at the level of reporting entity.

Question 2—Determination of ‘the Asset’ to be assessed for derecognition

Do you agree with the criteria proposed in paragraph 16A for what qualifies as the item (i.e. the Asset) to be assessed for derecognition? If not, why? What criteria would you propose instead, and why?

(Note: The criteria proposed in paragraph 16A are the same as those in FRS 39.)

4. We do not agree with the proposed criteria stated in paragraph 16A. We believe that disproportionate cash flows from a financial asset can represent identifiable cash flows and meet the recognition criteria in the financial statements of the transferee, and that these identifiable cash flows should then be derecognized in the financial statements of the transferor (rather than applying the test to the entire asset).

Question 3—Definition of ‘transfer’

Do you agree with the definition of a transfer proposed in paragraph 9? If not, why? How would you propose to amend the definition instead, and why?

5. We agree with the definition. The definition of “transfer” as explained in BC38 sets a clear principle that a reporting entity is required to consider the economic substance of a transaction undertaken, the BC39 states that “the proposed definition of “transfer” is to ensure that irrespective of their form, qualifying transactions will be assessed for derecognition”. This statement implies the ED has taken a principles-based approach to replace the complex and rules-based approach in the current derecognition requirements.

6. However, the ED further explains that it has defined “transfer” broadly, which could potentially imply many more transactions will be subject to derecognition test. The definition of “transfer” could be interpreted differently depending on various situations. For example, repos, which have been identified under AG40 as an example where derecognition would not apply, will most likely be derecognized under the new criteria, with a forward purchase recognized in its place. Arguably, capturing a repo as such does not reflect the real essence of what is primarily a secured borrowing from the view of the transferor.

7. We recommend IASB should carefully consider the unintended consequences (given the example above) so that it would be properly addressed and dealt with prior to the finalization of the proposals.

Question 4—Determination of ‘continuing involvement’

Do you agree with the ‘continuing involvement’ filter proposed in paragraph 17A(b), and also the exceptions made to ‘continuing involvement’ in paragraph 18A? If not, why? What would you propose instead, and why?

8. We do not agree with the ‘continuing involvement’ filter. Under the existing derecognition requirements, a transfer of financial assets is subject to a ‘risks and rewards’ test which enables a reporting entity to consider whether it should derecognize the assets. However, the ED proposes to replace the ‘risks and rewards’ test with the “continuing involvement” test. Under the proposed test, the asset would be derecognized if the transferor does not have any continuing involvement subsequent to the transfer.

9. We are concerned that the principle-based of “risks and rewards” test to derecognition is replaced with a much narrower, contractual cash-flow based continuing involvement approach. We are of a view that such drastic change will have a significant impact on the current accounting for financial assets if the notion of “risks and rewards” filter is removed entirely in the derecognition criteria.

Question 5—‘Practical ability to transfer for own benefit’ test

Do you agree with the proposed ‘practical ability to transfer’ derecognition test in paragraph 17A(c)? If not, why? What would you propose instead, and why?

(Note: Other than the ‘for the transferee’s own benefit’ supplement, the ‘practical ability to transfer’ test proposed in paragraph 17A(c) is the same as the control test in FRS 39.)

Do you agree with the ‘for the transferee’s own benefit’ test proposed as part of the ‘practical ability to transfer’ test in paragraph 17A(c)? If not, why? What would you propose instead, and why?

10. We do not agree that transferee always has the ability to transfer the Asset for its own benefit. The “practical ability to transfer” test as proposed in the ED is similar to the existing concept in the IAS 39 except that “for the transferee’s own benefit” has been added into the proposed to meet the effect of “for the transferee’s own benefit”. In this case, the transferee needs to demonstrate the ability to keep the proceeds from the transfer of the Asset itself. For example, if the transferee has an obligation to pass the consideration received on the transferred Asset from the third party to the transferor, it will not have the “practical ability to transfer the Asset for its own benefit”.

11. Instead of assessing the transferee’s “control” or “practical ability to transfer”, we are of the view that control is better evidenced by determining who has the risks and rewards inherent in the asset rather than focusing on the ability to transfer the asset.

12. The concept of ‘practical ability to transfer for own benefit’ test would lead to transactions not meeting the definition in the Framework to be recognized. It also results in the non-recognition of derivative entered into in connection with the transfer of the asset if the transferee does not have the practical ability to transfer.

13. For example, to a specific view in the context of securitization or the treatment of sale and repurchase agreement (repo transactions) involving readily obtainable securities which will represent sales of transferred assets under the proposed derecognition model, as compared to the existing derecognition regime where those have been treated as secured borrowing. We are of a view that such transactions in the above example, in substance, are not considered “sales” but should be treated as “secured borrowing”.

Question 6—Accounting for retained interests

Do you agree with the proposed accounting (both recognition and measurement) for an interest retained in a financial asset or a group of financial assets in a transfer that qualifies for derecognition (for a retained interest in a financial asset or group of financial assets, see paragraph 21A; for an interest in a financial asset or group of financial assets retained indirectly through an entity, see paragraph 22A)? If not, why? What would you propose instead, and why?

14. Yes, we agree.

Question 7—Approach to derecognition of financial assets

Having gone through the steps/tests of the proposed approach to derecognition of financial assets (Questions 1–6), do you agree that the proposed approach as a whole should be established as the new approach for determining the derecognition of financial assets? If not, why? Do you believe that the alternative approach set out in the alternative views should be established as the new derecognition approach instead, and, if so, why? If not, why? What alternative approach would you propose instead, and why?

15. The proposed “alternative approach” may be a simpler and clearer methodology to implement and should be given due consideration. However, the “alternative approach” has not yet explained in sufficient details for a conclusive comparison with the ED or IAS 39.

Question 8—Interaction between consolidation and derecognition

In December 2008, it issued an exposure draft ED 10 Consolidated Financial Statements. It believes that its proposed approach to derecognition of financial assets in this exposure draft is similar to the approach proposed in ED 10 (albeit derecognition is applied at the level of assets and liabilities, whereas consolidation is assessed at the entity level). Do you agree that the proposed derecognition and consolidation approaches are compatible? If not, why? Should it consider any other aspects of the proposed approaches to derecognition and consolidation before it finalizes the exposure drafts? If so, which ones, and why? If it were to consider adopting the alternative approach, do you believe that that approach would be compatible with the proposed consolidation approach?

16. The proposed approach to derecognition of financial assets in this ED is similar to the approach proposed in ED 10, which both focus on control in determining the possibly outcome. We are of a view that the “risks and rewards” should be included as one of the criteria to measure applicability of “derecognition” or “consolidation”, as the “risks and

rewards” approach reflects the real economic substance of transaction. We strongly think that we should not replace the existing risks and rewards test with a focus on single control concept.

Question 9—Derecognition of financial liabilities

Do you agree with the proposed amendments to the principle for derecognition of financial liabilities in paragraph 39A? If not, why? How would you propose to amend that principle instead, and why?

17. Yes, we agree.

Question 10—Transition

Do you agree with the proposed amendments to the transition guidance in paragraphs 106 and 107? If not, why? How would you propose to amend that guidance instead, and why?

18. Yes, we agree.

Question 11—Disclosures

Do you agree with the proposed amendments to FRS 107? If not, why? How would you propose to amend those requirements instead, and why?

19. The proposed disclosures are somewhat onerous and they may not provide incremental benefit and decision-useful information. In addition, for those transfers of financial assets that result in derecognition, there may be a possibility that the reporting entity has limited or no access to the information (both qualitative and quantitative) that are required to be disclosed under the proposal. The board should consider simplifying them, particularly the ones that are meant to capture the nature of and risks associated with an entity’s continuing involvement with derecognized assets.

20. Should you require any further clarification, do contact me. Thank you.

Yours faithfully,

Dexter Tan
Secretary, Accounting Standards Council