PROPOSED FINANCIAL REPORTING STANDARD	ED/FRS 39 & FRS 107

Exposure Draft of

DERECOGNITION
PROPOSED AMENDMENTS TO FRS 39 AND FRS 107

Comments to be received by 17 June 2009

This ED is issued by the Accounting Standards Council (ASC) for comment only and does not necessarily represent the views of ASC. The proposals may be modified in the light of the comments received before being issued as a Financial Reporting Standard (FRS).

Comments are most helpful if they indicate the specific paragraph or group of paragraphs to which they relate, clearly explain the problem and provide a suggestion for alternative wording with supporting reasoning.

Comments should be submitted in writing, so as to be received by 17 June 2009 preferably by email to MOF_Feedback_ASC@mof.gov.sg or addressed to:

Accounting Standards Council
c/o Ministry of Finance
100 High Street #10-01
The Treasury
Singapore 179434

Contents

INTRODUCTION
INVITATION TO COMMENT

PROPOSED AMENDMENTS TO FRSs:

FRS 39 ***FINANCIAL INSTRUMENTS: RECOGNITION AND MEASUREMENT***

FRS 107 ***FINANCIAL INSTRUMENTS: DISCLOSURES***

AMENDMENTS TO OTHER FRSs

PROPOSED AMENDMENTS TO GUIDANCE ON IMPLEMENTING FRSs:

FRS 39 IMPLEMENTATION GUIDANCE

FRS 101 IMPLEMENTATION GUIDANCE

FRS 107 IMPLEMENTATION GUIDANCE

Introduction

Background

IN1 [Not used]

IN2 One reason for the complexity of FRS 39 is that it is internally inconsistent: it combines elements of various derecognition concepts (risks and rewards, control and continuing involvement) and requires them to be applied in a specified order to determine whether all or part of a previously recognised financial asset should be derecognised. In summary:

(a) FRS 39 permits a financial asset to be separated into parts only in defined circumstances. Otherwise it requires the derecognition tests to be applied to the entire asset.

(b) An entity must consider whether it has 'transferred' the asset to another party and, if so, whether it has also transferred substantially all the risks and rewards of the asset. If so, the entity derecognises the asset.

(c) Otherwise the entity determines whether it has retained control of the asset. If it has retained control of the asset, the entity recognises the asset only to the extent of its 'continuing involvement' in the asset. If it has not retained control of the asset, the entity derecognises the asset.

IN3 Another example of the complexity of FRS 39 is that it provides little guidance about how the 'substantially all the risks and rewards' test should be applied. Questions have arisen in practice about:

(a) whether each identified risk and reward should be substantially surrendered to allow for derecognition

(b) whether all risks should be aggregated separately from all rewards

(c) whether risks and rewards should be offset and then combined for evaluation

(d) how 'substantially all' should be interpreted in the evaluation of those risks and rewards.

IN4 [Not used]

IN5 [Not used]

IN6 [Not used]

IN7 [Not used]

N8 [Not used]

IN9 In developing the proposed approach to derecognition of financial assets, various factors were considered, including the following:

(a) *Complexity*—The derecognition requirements in FRS 39 are difficult to understand and apply in practice.

(b) *Convergence*—The derecognition project presents an opportunity to improve FRSs and US GAAP requirements on this topic, and achieve convergence.

(c) *Market environment*—Regulators and others have called for an improvement to, and convergence of, derecognition requirements.

(d) *Users' requests*—Users have repeatedly asked for more transparency in the accounting and reporting of transfer transactions, particularly those that involve securitisation vehicles.

(e) *Divergent views*—Constituents and members alike have divergent views on the substance of a transfer of a financial asset if the transferring entity maintains some involvement in the asset. Is the transfer a sale of the asset or is it a borrowing secured by the 'transferred' asset? To a large extent, the divergence in views on the substance of a transfer is caused by a lack of agreement on 'the asset that is the subject of a transfer'. In particular, can a financial asset be divided into smaller and smaller parts that are assets in their own right that may then qualify for derecognition? If so, can those parts be rights to any cash flows of the previously recognised financial asset, or rights to only particular types of cash flows?

Summary of the proposals

IN10 The proposed amendments would replace the approach to derecognition of financial assets in FRS 39 with an approach that is similar in that

(a) it uses the same criteria for when a transferred part of a financial asset qualifies to be assessed for derecognition (with some additional guidance to address known application issues);

(b) it uses a test of control (although unlike FRS 39 that test has primacy); and

(c) many of the derecognition outcomes will be similar (the notable exceptions being transfers, such as repurchase agreements, involving readily obtainable financial assets).

IN11 However, the proposed approach is different from FRS 39 in that it does not combine elements of several derecognition concepts but rather focuses on a single element (control). As a result, unlike FRS 39, the proposed approach does not have:

(a) a test to evaluate the extent of risks and rewards retained;

(b) specific pass-through requirements; or

(c) a requirement for a transferor (in a transfer that fails derecognition) to recognise and measure a financial asset to the extent of its continuing involvement.

IN12 As noted in paragraph IN9(e), it was divided on the appropriate approach to derecognition of financial assets. A majority of whom favoured (and decided on) the derecognition approach proposed in this exposure draft. However, others preferred an alternative approach. Like the proposed approach, the alternative approach bases the decision of whether an entity should derecognise a transferred financial asset on whether the entity has surrendered control of the asset. However, unlike the proposed approach, the alternative approach assesses control

differently, and with that, has a different perspective of what the asset that is the subject of the transfer is. The alternative approach is described in more detail as part of the alternative views.

IN13 The proposed amendments also would revise the approach to derecognition of financial liabilities in FRS 39 to be more consistent with the definition of a liability in the *Framework*.

IN14 The proposed amendments to FRS 107 *Financial Instruments: Disclosures* would enhance the disclosures in that FRS to improve the evaluation of risk exposures and performance in respect of an entity's transferred financial assets.

Invitation to comment

The ASC invites comments on all matters in this exposure draft, in particular on the questions set out in the paragraphs below. Comments are most helpful if they:

(a) respond to the questions as stated

(b) indicate the specific paragraph(s) to which they relate

(c) contain a clear rationale

(d) if applicable, provide a suggestion for alternative wording it should consider.

ASC is not seeking comments on other aspects of FRS 39 or FRS 107.

Comments should be submitted in writing so as to be received no later than **17 June 2009**.

Question 1—Assessment of 'the Asset' and 'continuing involvement' at reporting entity level

Do you agree that the determination of the item (ie 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?

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 (ie 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.)

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?

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?

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?

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?

(Note: The accounting for a retained interest in a financial asset or group of financial assets that is proposed in paragraph 21A is not a change from FRS 39. However, the guidance for an interest in a financial asset or group of financial assets retained indirectly through an entity as proposed in paragraph 22A is new.)

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?

Question 8—Interaction between consolidation and derecognition

In December 2008, an exposure draft ED 10 *Consolidated Financial Statements* was issued It is believed that the 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 finalises the exposure drafts? If so, which ones, and why? If it were to consider adopting the alternative approach, do you believe that approach would be compatible with the proposed consolidation approach?

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?

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?

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?

Proposed amendments to FRS 39 *Financial Instruments: Recognition and Measurement*

Scope

Paragraphs 2(b) and (h) are amended (new text is underlined and deleted text is struck through).

2 This Standard shall be applied by all entities to all types of financial instruments except:

(a) …

(b) rights and obligations under leases to which FRS 17 *Leases* applies. However:

(i) lease receivables recognised by a lessor are subject to the derecognition and impairment provisions of this Standard (see paragraphs 15A–~~37~~24A, 58, 59~~,~~ and 63–65 ~~and Appendix A paragraphs AG36–AG52 and AG84–AG93~~);

(ii) finance lease payables recognised by a lessee are subject to the derecognition provisions of this Standard (see paragraphs 39A– 42B ~~and Appendix A paragraphs AG57–AG63~~); and

(c)–(g) …

(h) loan commitments other than those loan commitments described in paragraph 4. An issuer of loan commitments shall apply FRS 37 *Provisions, Contingent Liabilities and Contingent Assets* to loan commitments that are not within the scope of this Standard. However, all loan commitments are subject to the derecognition provisions of this Standard (see paragraphs 15A–42B ~~and Appendix A paragraphs AG36–AG63~~).

Definitions

Paragraph 9 is amended (new text is underlined and deleted text is struck through).

Definitions relating to recognition and measurement

…

Derecognition **~~is the removal of a previously recognised financial asset or financial liability from~~ of a financial asset or liability is ceasing to recognise that asset or liability in an entity's statement of financial position.**

…

A *transfer* takes place when one party passes, or agrees to pass, to another party some or all of the economic benefits underlying one or more of its assets. The term 'transfer' is used broadly to include all forms of sale, assignment, provision of collateral, sacrifice of benefits, distribution and other exchange. (A transfer does not necessarily result in derecognition.)

Recognition and derecognition

Paragraphs 15–24 are deleted and replaced by paragraphs 15A–24A. Paragraphs 25–37 are deleted (as a result, the next paragraph after paragraph 24A is paragraph 38).

Derecognition of a financial asset

15A An entity determines the item to be assessed for derecognition in paragraph 16A, and assesses continuing involvement in paragraphs 17A and 18A, at the level of the reporting entity. Hence, if the reporting entity is the group, an entity first consolidates all subsidiaries in accordance with FRS 27 and INT FRS 12 *Consolidation—Special Purpose Entities* and then applies those paragraphs to the resulting group.

16A An entity applies paragraphs 17A and 18A to a part of a financial asset (or a part of a group of financial assets) only if that part comprises specifically identified cash flows or a proportionate share of the cash flows from that financial asset (or that group of financial assets) (ie the performance of the part retained does not depend on the performance of the part transferred, and vice versa). If there are two or more transferees, no transferee is required to have a proportionate share of the cash flows from the asset (or the group of financial assets) provided that the transferring entity has a proportionate share. In all other cases, paragraphs 17A and 18A are to be applied to the financial asset (or group of financial assets) in its entirety. In paragraphs 17A and 18A, the term 'the Asset' refers to either a part of a financial asset (or a part of a group of financial assets) as identified in this paragraph or, otherwise, a financial asset (or a group of financial assets) in its entirety.

17A An entity shall derecognise the Asset if:

(a) the contractual rights to the cash flows from the Asset expire;

(b) the entity transfers the Asset and has no continuing involvement in it; or

(c) the entity transfers the Asset and retains a continuing involvement in it but the transferee has the practical ability to transfer the Asset for the transferee's own benefit.

18A A transferor has no continuing involvement in the Asset if, as part of the transfer, it neither retains any of the contractual rights or obligations inherent in the Asset nor obtains any new contractual rights or obligations relating to the Asset. None of the following constitutes continuing involvement:

(a) normal representations and warranties relating to fraudulent transfer and concepts of reasonableness, good faith and fair dealings that could invalidate a transfer as a result of legal action;

(b) the retention of the right to service the Asset in a fiduciary or agency relationship; or

(c) forward, option and other contracts associated with reacquiring the Asset for which the contract (or exercise) price is the fair value of the transferred Asset.

Transfers that qualify for derecognition (see paragraph 17A(b) and (c))

19A For a transfer of all or part of a financial asset that meets the derecognition criteria in paragraph 17A(b) and (c), the transferor shall recognise any new assets obtained or new liabilities assumed in the transfer and initially measure them at fair value.

20A For a transfer of an entire financial asset that meets the derecognition criteria in paragraph 17A(b) and (c), the transferor shall recognise in profit or loss the difference between:

(a) the carrying amount of the asset transferred (and derecognised) and

(b) the sum of

(i) the consideration received (including any new assets obtained less any new liabilities assumed) and

(ii) any cumulative gain or loss that the entity had recognised in other comprehensive income (see paragraph 55(b)).

21A For a transfer of a part of a financial asset that meets the derecognition criteria in paragraph 17A(b) and (c), the transferor shall account for the part retained as part of the financial asset recognised before the transfer. As a result, the entity shall allocate the carrying amount of the financial asset previously recognised between the part retained and the part transferred (and derecognised) on the basis of the relative fair values of those parts on the date of transfer. The entity shall recognise in profit or loss the difference between:

(a) the carrying amount allocated to the part transferred (and derecognised) and

(b) the sum of

(i) the consideration received for the part transferred (and derecognised) (including any new assets obtained less any new liabilities assumed) and

(ii) any cumulative gain or loss that the entity had recognised in other comprehensive income (see paragraph 55(b)) and allocated to the part transferred.

The entity allocates a cumulative gain or loss that it had recognised in other comprehensive income between the part retained and the part transferred (and derecognised) on the basis of the relative fair values of those parts on the date of transfer.

22A If an entity transfers an entire financial asset or a group of financial assets to another entity in a transfer that qualifies for derecognition and, as part of the transfer, purchases an interest in that entity (which gives it the right to some of the cash flows from that asset or group of assets), it shall treat such interest as a retained part of the asset or group of assets previously recognised. If the transferee has other financial assets or liabilities in addition to those received from the transferring entity, the transferring entity shall split the interest purchased following the guidance in paragraph 21A between

(a) an interest in the previously recognised asset or group of assets, and

(b) an interest in new assets or new liabilities.

Transfers that do not qualify for derecognition (see paragraph 17A(b) and (c))

23A For a transfer of all or part of a financial asset that fails the derecognition criteria in paragraph 17A(b) and (c), the entity shall continue to recognise the financial asset in its entirety and shall recognise a financial liability for the consideration received (the entity shall not offset the asset and the liability). In subsequent periods, the entity shall recognise any income on the transferred asset and any expense incurred on the financial liability (the entity shall not offset the income and expense). (See FRS 32 paragraph 42.)

24A If an entity measures at amortised cost a financial asset that it continues to recognise following a transfer, it shall not apply to the associated liability the option in this Standard to designate a financial liability as at fair value through profit or loss.

Paragraphs 39-42 are deleted and replaced with paragraphs 39A-42B.

Derecognition of a financial liability

39A An entity shall derecognise a financial liability (or a part of it) when it (or the part) no longer qualifies as a liability of the entity. A financial liability ceases to qualify as a liability of an entity if the present obligation is eliminated and the entity is no longer required to transfer economic resources in respect of that obligation.

40A If an entity exchanges one debt instrument with the creditor for another debt instrument, it derecognises the financial liability associated with the previous debt instrument and recognises a new financial liability if the terms of the debt instruments are substantially different. Similarly, if an entity and a creditor agree to modify substantially the terms of a debt instrument (whether or not as a result of the financial difficulty of the entity), the entity derecognises the associated financial liability and recognises a new financial liability. (This paragraph applies only if the exchange or modification is not a transfer of a financial asset, as that term is defined in paragraph 9. If the exchange or modification is a transfer of a financial asset, that asset shall be assessed for derecognition following the criteria in paragraphs 15–18A. To the extent the asset qualifies for derecognition, the entity derecognises it, and also derecognises the financial liability associated with the previous debt instrument.)

41A If an entity derecognises a financial liability, it shall recognise in profit or loss the difference between:

(a) the carrying amount of the liability derecognised and

(b) the consideration paid (including any non-cash assets transferred or liabilities assumed).

42A If an entity derecognises a part of a financial liability, the entity shall allocate the previous carrying amount of the financial liability between the part that it continues to recognise and the part that it derecognises according to the relative fair values of those parts on the date of derecognition. The entity shall recognise in profit or loss the difference between

(a) the carrying amount allocated to the part derecognised and

(b) the consideration paid (including any non-cash assets transferred or liabilities assumed) for the part derecognised.

42B If an entity derecognises a financial liability as a result of an exchange of debt instruments or

modification of terms, it includes any costs or fees incurred in the gain or loss recognised. If an entity does not derecognise a financial liability in connection with an exchange or modification, it adjusts the carrying amount of the liability for any costs or fees incurred and amortises the new carrying amount over the remaining term of the liability.

Measurement

Paragraph 47(b) is amended (new text is underlined and deleted text is struck through).

Subsequent measurement of financial liabilities

47 **After initial recognition, an entity shall measure all financial liabilities at amortised cost using the effective interest method except for:**

(a) **…**

(b) **financial liabilities that arise when a transfer of a financial asset does not qualify for derecognition ~~or when the continuing involvement approach applies~~. Paragraphs ~~29 and 31~~ 23A and 24A apply to the measurement of such financial liabilities.**

Paragraphs 106 and 107 are amended (new text is underlined and deleted text is struck through).

Effective date and transition

106 *Derecognition* (Amendments to FRS 39 and FRS 107), issued in [month and year], amended paragraphs 2, 9 and 47(b), and deleted paragraphs 15–37 and 39–42 and replaced them with paragraphs 15A–24A and 39A–42B. Except as permitted by paragraph 107, an entity shall apply ~~the derecognition requirements in paragraphs 15–37 and Appendix A paragraphs AG36–AG52~~ those amendments prospectively to transactions entered into after [date]. Accordingly~~,~~:

(a) ~~i~~If an entity derecognised financial assets or financial liabilities ~~under~~ in accordance with FRS 39 (revised 200~~0~~3) as a result of a transaction ~~that occurred~~ entered into before ~~1 January 2004~~ [date specified above] or, if applicable, the earlier date from which the entity elected to apply the amendments and those assets or liabilities would not have been derecognised ~~under~~ in accordance with ~~this Standard~~ FRS 39 [as proposed to be amended], it shall not recognise those assets or liabilities (unless they qualify for recognition as a result of a later transaction or event).

(b) If, in accordance with FRS 39 (revised 2003), an entity did not derecognise financial assets or financial liabilities as a result of a transaction entered into before [date specified above] or, if applicable, the earlier date from which the entity elected to apply the amendments and those assets or liabilities would have been derecognised in accordance with FRS 39 [as proposed to be amended], it shall not derecognise those assets or liabilities (unless they qualify for derecognition as a result of a later transaction or event).

107 Notwithstanding paragraph 106, an entity may apply the ~~derecognition requirements in paragraphs 15–37 and Appendix A paragraphs AG36– AG52~~ amendments resulting from *Derecognition* (Amendments to FRS 39 and FRS 107), issued in [month and year], ~~retrospectively~~ prospectively to transactions entered into before the ~~from a~~ date ~~of the entity's choosing~~ specified in paragraph 106, provided that the entity obtained the information needed to apply FRS 39 [as proposed to be amended] to assets and liabilities derecognised as a result of past transactions ~~was obtained~~ at the time ~~of~~ it initially account~~ing~~ed for those transactions. If an entity elects to apply the

amendments prospectively to transactions entered into before the date specified in paragraph 106, it shall disclose that fact, and it shall apply the amendments to *all* transactions from that date.

Appendix A
Application guidance

Scope (paragraphs 2–7)

Paragraph AG4(a) is amended (new text is underlined and deleted text is struck through).

AG4 Financial guarantee contracts may have various legal forms, such as a guarantee, some types of letter of credit, a credit default contract or an insurance contract. Their accounting treatment does not depend on their legal form. The following are examples of the appropriate treatment (see paragraph 2(e)):

(a) Although a financial guarantee contract meets the definition of an insurance contract in FRS 104 if the risk transferred is significant, the issuer applies this Standard. Nevertheless, if the issuer has previously asserted explicitly that it regards such contracts as insurance contracts and has used accounting applicable to insurance contracts, the issuer may elect to apply either this Standard or FRS 104 to such financial guarantee contracts. If this Standard applies, paragraph 43 requires the issuer to recognise a financial guarantee contract initially at fair value. If the financial guarantee contract was issued to an unrelated party in a stand-alone arm's length transaction, its fair value at inception is likely to equal the premium received, unless there is evidence to the contrary. Subsequently, unless the financial guarantee contract was designated at inception as at fair value through profit or loss or unless paragraphs ~~29–37~~ 23A and 24A ~~and AG47–AG52~~ apply (when a transfer of a financial asset does not qualify for derecognition ~~or the continuing involvement approach applies~~), the issuer measures it at the higher of:

(i) the amount determined in accordance with FRS 37; and

(ii) the amount initially recognised less, when appropriate, cumulative amortisation recognised in accordance with FRS 18 (see paragraph 47(c)).

The heading after paragraph AG33B, and paragraph AG34, are amended (new text is underlined and deleted text is struck through).

Recognition and derecognition (paragraphs 14–42B)

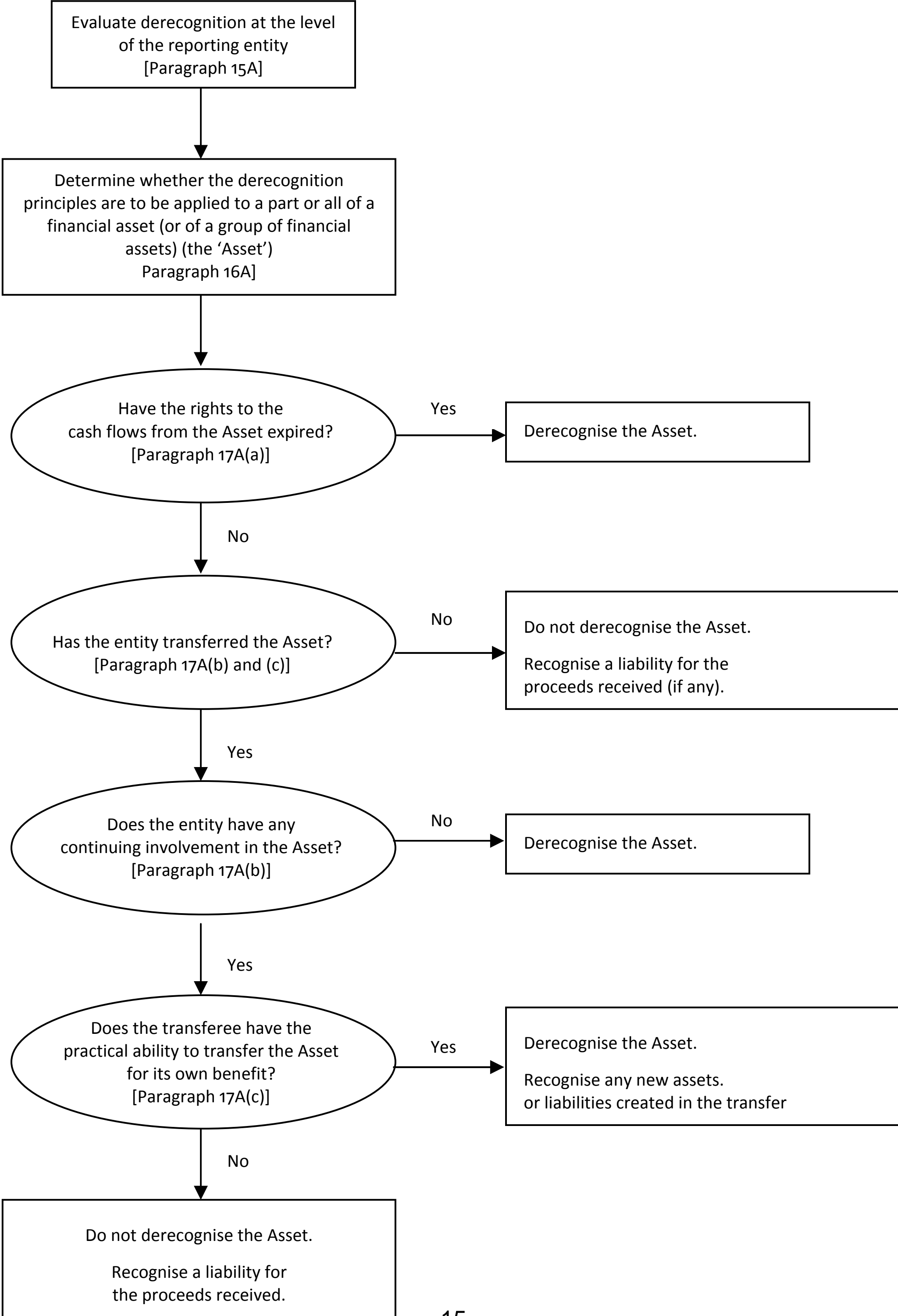
Initial recognition (paragraph 14)

AG34 ~~As a consequence of t~~The principle in paragraph 14~~,~~ results in an entity recognis~~es~~ing as assets and liabilities in its statement of financial position all of its contractual rights and obligations ~~under~~ associated with derivatives ~~in its statement of financial position as assets and liabilities~~, respectively, except for derivatives that prevent a transfer of financial assets from being accounted for as a sale (see paragraph AG~~49~~52J). If a transfer of a financial asset does not qualify for derecognition by the transferor, the transferee does not recognise the transferred asset as its asset (see paragraph AG~~50~~52K).

The heading before paragraph AG36 is amended (new text is underlined and deleted text is struck through). Paragraphs AG36–AG52 are deleted and replaced with paragraphs AG36A–AG52A. Paragraphs AG52B–AG52L are added.

Derecognition of a financial asset (paragraphs 15A–~~37~~24A)

AG36A The following flow chart illustrates the evaluation of whether and to what extent a financial asset (or a group of financial assets) is derecognised.



The 'Asset' to be assessed for derecognition (paragraph 16A)

AG37A The determination of the item (ie the Asset) to be assessed for derecognition is made at the level of the reporting entity on the basis of that entity's remaining interest in the financial asset that was the subject of the transfer. For example, if an entity transfers to another entity:

(a) a proportionate 80 per cent interest in a loan portfolio or

(b) 100 per cent of a loan portfolio in exchange for cash and a proportionate 20 per cent interest in that portfolio,

the Asset to be assessed for derecognition is a proportionate 80 per cent of the loan portfolio (irrespective of whether the transferring entity's retained proportionate 20 per cent share is an interest in the portfolio or an interest in the entity to which it transferred the portfolio).

Transfer of an entire financial asset

AG38A For a transfer of an entire financial asset or the right to all the cash flows or other economic benefits of a financial asset, the Asset to be evaluated for derecognition is the entire financial asset. Transferring the right to the cash flows of an entire financial asset is akin to transferring the asset itself. For example, for a transfer of the right to all cash flows of a loan, the Asset to be assessed for derecognition is the loan, irrespective of the fact that the transferring entity did not transfer to the transferee (via a legal assignment or otherwise) the loan contract it has with the borrower.

Transfer of a part of a financial asset

AG39A If the part of a financial asset transferred does not meet the conditions in paragraph 16A (ie the part does not comprise specifically identified cash flows or a proportionate share of the cash flows from the asset—the performance of the part transferred does not depend on the performance of the part retained, and vice versa), the Asset to be assessed for derecognition is the entire financial asset, regardless of the fact that only a part of the financial asset was the subject of the transfer. For example, for a transfer of the right to the *first* 90 per cent of the cash flows of a loan, the Asset to be assessed for derecognition is the entire loan.

AG40A Similarly, transferring the right to the cash flows of a part of a financial asset that meets the conditions in paragraph 16A is akin to transferring the part itself. For example, for a transfer of the right to a proportionate 80 per cent share of the cash flows of a loan, the Asset is 80 per cent of the loan. (Hence, '20 per cent of the loan' would be considered a retained part of the previously recognised loan if the transfer qualified for derecognition, and the guidance in paragraph 21A would apply).

AG41A For a transfer of a part of a financial instrument that can be an asset or a liability over its life, the Asset is the entire instrument. For example, for a transfer of the 'receive' leg of an interest rate swap, the Asset is the swap. (Because the swap can be an asset or a liability over its term, the swap would have to meet *both* the derecognition criteria for financial assets in paragraph 17A and those for financial liabilities in paragraph 39A for it to be derecognised. As a result, a transfer of only the 'receive' leg of an interest rate swap, for example, does not qualify for derecognition.)

Transfer of a group of financial assets

AG42A For a transfer of a group of financial assets, the assets shall be evaluated for derecognition as a group (ie the Asset is the group of assets) to the extent that none of the assets in the group is an instrument that can be an asset or a liability over its life. Otherwise, the assets shall be evaluated for derecognition individually. For example, for a transfer of a portfolio of a floating rate loan and

an interest rate swap, the loan and swap would be assessed for derecognition individually and the requirements in paragraph 17A(b) and (c) would apply to them separately.

AG43A Similarly, for a transfer of a part of a group of financial assets, the Asset is the part transferred only if

(a) the part meets the conditions in paragraph 16A and

(b) none of the assets in the group is an instrument that can be an asset or a liability over its life.

Meaning of 'transfer' (paragraph 17A(b) and (c))

AG44A An entity shall treat a transaction involving a financial asset as a transfer (and, as such, assess it for derecognition) if as part of the transaction it passes or agrees to pass to another party some or all of the cash flows or other economic benefits underlying that asset. Hence, irrespective of its legal form, a transaction shall be assessed for derecognition if it meets the definition of a transfer. For example, an entity might obtain a loan that it must repay (both principal and interest) only from proceeds generated by a specified asset in which the lender has a security interest (or by the transfer of the asset itself) and then only to the extent that the asset generates sufficient funds. In that case, the entity shall assess for derecognition the loan as a transfer of the securing financial asset. (The fact that a transaction meets the definition of a transfer does not necessarily mean that it will qualify for derecognition).

AG45A Similarly, an entity treats the issue of debt or equity instruments (beneficial interests) as a transfer of specific financial assets of that entity if, according to the terms of the instruments, the entity has agreed to remit to the holders some or all of the cash flows of those assets (this guidance applies irrespective of whether the certificates provide the holders with an interest in the entity or in the assets of that entity).

Transferor's continuing involvement (paragraphs 17A(b) and (c) and 18A)

AG46A In paragraphs AG47A–AG52G, 'the Asset' refers to either a part of a financial asset (or a part of a group of financial assets) as identified in paragraph 16A or a financial asset (or a group of financial assets) in its entirety.

AG47A The assessment of continuing involvement in the Asset is made at the level of the reporting entity. For example, if a subsidiary transfers to an unrelated third party a financial asset in which the parent of the subsidiary has continuing involvement, the subsidiary does not include the parent's involvement in the assessment of whether the asset qualifies for derecognition in its stand-alone financial statements (ie when the subsidiary is the reporting entity). However, a parent would include its continuing involvement (or that of another member of the group) in a financial asset transferred by its subsidiary in the derecognition assessment in its consolidated financial statements (ie when the reporting entity is the group).

AG48A An entity does not have a continuing involvement in the Asset if, as part of the transfer, it neither retains any of the contractual rights or obligations inherent in the Asset nor acquires any new contractual rights or obligations relating to the Asset. For example, an entity does not have continuing involvement in the Asset if it has neither an interest in the future performance of the Asset nor a responsibility under any circumstances to make payments in respect of the Asset in the future.

AG49A Paragraph 18A(b) excludes from the assessment of continuing involvement the retention by a transferor of the right to service the Asset in a fiduciary or agency relationship. Such a

relationship would be present if:

(a) the fees paid to the transferor are compensation for services provided and are commensurate with the level of effort required to provide those services (eg the service arrangement does not include terms, conditions or amounts that are not customarily present in arrangements for similar services negotiated at arm's length);

(b) the fees are senior in priority to any payment to the transferee from the serviced Asset; and

(c) the transferee has the right to terminate the servicing contract with the transferor.

AG50A Continuing involvement in the Asset may result from contractual provisions in the transfer agreement or in a separate agreement with the transferee or a third party entered into in connection with the transfer.

Transferee's practical ability to transfer for its own benefit (paragraph 17A(c))

AG51A For a transferee to have the practical ability to transfer the Asset for its own benefit, it must be in a position immediately after the transfer from the transferor to transfer, for its own benefit, the Asset to an unrelated third party *unilaterally* and *without having to impose additional restrictions* on that transfer.

Meaning of 'unilaterally'

AG52A To be in a position to transfer the Asset to an unrelated third party unilaterally, a transferee must have the ability to dispose of the Asset independently of the actions of others (except for the actions of the potential third-party buyer). For example, a transferee may have to obtain the consent of the transferor before it can transfer the Asset to a third party. In that case, if the transferor can withhold its consent without reason, the transferee does not have the ability to transfer the Asset unilaterally. On the other hand, if the transferor cannot unreasonably withhold its consent, the transferee has the ability to transfer the Asset unilaterally (provided the transferee can realise the full economic benefits of the Asset upon the transfer).

Meaning of 'without additional restrictions'

AG52B To be in a position to transfer the Asset to an unrelated third party without having to impose additional restrictions, a transferee must be able to dispose of the Asset in isolation, ie without having to add restrictive conditions to the transfer of the Asset to that party. For example, if a transferor imposed obligations on the transferee concerning the servicing of the Asset, the transferee would have to impose those obligations on any entity to which it transfers the Asset. Hence, the transferee would not have the ability to transfer the Asset to a third party 'without additional restrictions'. The 'additional restrictions' may be in a contract separate from the contract for the transfer of the Asset, or the transfer contract and the 'additional restrictions' may be in a single contract.

AG52C An additional restriction is not a feature inherent in the Asset (ie it must be a feature that was not part of the Asset before the transfer). For example, a convertible bond contains a conversion option, which is already part of the bond. In a transfer of such a bond, the conversion option is not an additional restriction that would prevent the transferee from having the practical ability to transfer the convertible bond to a third party. On the other hand, in a transfer of a not readily obtainable convertible bond with a separate call option written by the transferee at the time of the transfer enabling the transferor to repurchase the convertible bond, the call option is an additional contract that may cause the transferee not to have the ability to transfer the convertible bond 'without any additional restrictions'. For example, the transferee might have to attach to the

convertible bond a similar option in a subsequent transfer to avoid default if the transferor were to exercise the call option.

Meaning of 'for its own benefit'

AG52D To have the practical ability to transfer the Asset to an unrelated third party 'for its own benefit', a transferee must be in a position to keep for itself the consideration it would receive from an unrelated third party if it were to transfer the Asset to that party. Hence, if the transferee had an obligation to pass any such consideration from the third party on to the transferor, it would not meet the 'for its own benefit' requirement in the 'practical ability to transfer' test.

Factors to consider in assessing 'practical ability to transfer'

AG52E Determining whether a transferee has the practical ability to transfer the Asset requires judgement, after considering all the relevant facts and circumstances. Some factors to consider in making that determination are:

(a) *the terms of the transfer (contractual) arrangement, including other contracts or arrangements entered into in relation to the transfer*

In assessing a particular transfer, it is necessary to consider any related arrangements, including any side agreements or sets of agreements entered into contemporaneously with, or in contemplation of, the transfer of the Asset.

(b) *the nature of the Asset (fungibility and obtainability)*

A contractual prohibition on disposing of the Asset (or the absence of an explicit contractual right to dispose of it) may not prevent the transferee from having the practical ability to transfer the Asset to a third party if the transferee can readily obtain a replacement asset. Replacement assets are deemed to be readily obtainable if the Asset is actively traded on an accessible market (at the date of transfer).

(c) *the market for the Asset*

A restriction or limitation that is effective on the number or identity of the parties to whom the transferee can transfer the Asset will have no practical effect if enough other potential buyers exist to create a market for the transfer of the Asset. Although the Asset involved in a transfer may not be readily replaceable, because of market convention, other established practice or an express or implied term of the transaction, the transferor may consider an asset that is not identical to the Asset an acceptable replacement for the Asset. If so, the other arrangements entered into by the parties to the transfer (as part of the transfer) would not prevent the transferee from having the ability to transfer the Asset.

(d) *the transferee's ability to obtain the full economic benefits of the Asset*

Any rights retained by a transferor that do not prevent the transferee from obtaining the full economic benefits of the Asset do not have any effect on the 'practical ability to transfer' test. For example, a transferor's right to match a bona fide offer received by the transferee from a third party does not prevent the transferee from having the ability to transfer the Asset to a third party. In such a case, if the repurchase were to be made in accordance with the contract, the transferee's position would be no better or worse than if it had sold that asset in the market on that day. The same analysis applies to a transfer for which the transferor retains a first right of refusal on the Asset or a repurchase right at the prevailing market value of the Asset.

(e) *economic constraints*

If a transferee stands to incur losses on the transfer of the Asset to a third party, it may be economically impeded from transferring the Asset to a third party, and therefore judged not to be practically free and able to do so. For example, a put option or a guarantee may constrain a transferee's ability to dispose of the Asset unless replacement assets are readily obtainable. This is because the transferee may be unlikely to forfeit the benefit of the option or guarantee (eg if the option or guarantee is sufficiently valuable to the transferee) without attaching a similar option, guarantee or other restrictive conditions on the transfer of that asset to a third party.

Reassessment of the 'practical ability to transfer' test

AG52F A transfer that does not qualify for derecognition because the transferee is deemed not to have the practical ability to transfer the Asset to a third party for its own benefit would subsequently qualify for derecognition if conditions changed so as to give the transferee that ability (for example, the Asset, which was not readily obtainable at the date of transfer, subsequently becomes readily obtainable). Subsequent events that change the probability of an option being exercised (other than the exercise or expiration of the option itself) would not trigger (nor would they be factored into) any reassessment.

AG52G Once a transferor derecognises the Asset because it judges that the transferee has the practical ability to transfer that asset to a third party for the transferee's own benefit, it does not re-recognise the Asset if conditions subsequently change resulting in the transferee no longer having that practical ability.

Transfers that qualify for derecognition

AG52H If an entity transfers an entire financial asset in a transfer that qualifies for derecognition and retains the right to service that asset for a fee, it recognises:

(a) a servicing asset if the fee to be received is expected to compensate the entity more than adequately for the level of effort required to provide those services, and

(b) a servicing liability if the fee is expected not to compensate the entity adequately.

An entity initially measures a servicing asset at an amount determined on the basis of an allocation of the carrying amount of the previously recognised financial asset in accordance with paragraph 21A. An entity initially measures a servicing liability at fair value.

AG52I An entity may retain the right to a part of the interest payments on transferred assets as compensation for servicing those assets. The part of the interest payments that the entity would give up on termination or transfer of the servicing contract is allocated to the servicing asset or servicing liability. The part of the interest payments that the entity would not give up is an interest-only strip receivable. For example, if the entity would not give up any interest upon termination or transfer of the servicing contract, the entire interest spread is an interest-only strip receivable. For the purposes of applying paragraph 21A, the fair values of the servicing asset and interest-only strip receivable are used to allocate the carrying amount of the receivable between the part of the asset that is derecognised and the part that continues to be recognised. If no servicing fee is specified or the fee to be received is not expected to compensate the entity adequately for the level of effort required to provide those services, the entity recognises a liability for the servicing obligation and initially measures it at fair value.

Transfers that do not qualify for derecognition

AG52J To the extent that a transfer of a financial asset does not qualify for derecognition, the transferor's

contractual rights or obligations related to the transferred asset are not accounted for separately as derivatives if recognising both the derivatives and either the transferred asset or the liability arising from the transfer would result in recognising the same rights or obligations twice. For example, a call option retained by the transferor may prevent a transfer of financial assets from being accounted for as a sale. In that case, the call option is not separately recognised as a derivative asset.

AG52K To the extent that a transfer of a financial asset does not qualify for derecognition, the transferee does not recognise the transferred asset as its asset. The transferee derecognises the cash or other consideration paid and recognises a receivable from the transferor.

Examples

AG52L The following examples illustrate the application of the derecognition requirements in paragraph AG36A.

(a) *Transfer of a readily obtainable financial asset with a derivative*. If a transferor transfers a readily obtainable financial asset (eg an instrument publicly traded in an active market) and as part of the transfer enters into a derivative (eg repurchase agreement, call option, put option or total return swap) with the transferee, 'the Asset' is the financial asset sold and the derivative represents continuing involvement by the transferor in the Asset. This is because the derivative is a new asset or liability obtained by the transferor in connection with the transfer and through the derivative the transferor has an interest in the future performance of the Asset or a responsibility under defined circumstances to make payments in respect of the Asset in the future. Because the Asset is readily obtainable, the transferee has the practical ability to transfer the Asset to an unrelated third party for its own benefit. The transferee does not have to combine the Asset with the derivative in order to transfer it. Also, the transferee has the ability to obtain a replacement asset readily when the derivative is settled (if settlement of the derivative were to require physical delivery). Furthermore, the transferee has the practical ability to transfer the Asset 'for its own benefit' because it can use the full proceeds from any such subsequent transfer as it pleases (ie the transferee does not have an obligation to return those proceeds to the transferor). In summary, the transfer of the Asset results in the transferor passing control of the Asset to the transferee. The transferor derecognises, and the transferee recognises, the Asset, and both parties recognise the derivative.

(b) *Transfer of a not readily obtainable financial asset with a derivative.* If a transferor transfers a financial asset that is not readily obtainable (eg an originated loan or an ordinary share that is not publicly traded in an active market), and as part of the transfer enters into a derivative (eg repurchase agreement, call option, put option or total return swap) with the transferee, 'the Asset' is the financial asset sold. The derivative represents continuing involvement by the transferor in the Asset, because the derivative is a new asset or liability obtained by the transferor in connection with the transfer and through the derivative the transferor has an interest in the future performance of the Asset or a responsibility under defined circumstances to make payments in respect of the Asset in the future. Because the Asset is not readily obtainable, the transferee is unlikely to have the practical ability to transfer the Asset to an unrelated third party for its own benefit provided the derivative is to be physically settled. If the derivative is to be net settled, the transferee generally has the practical ability to transfer the Asset to an unrelated third party for its own benefit (but see the net-settled total return swap scenario in paragraph AG52L(h)). If the derivative is to be physically settled, the transferee would have to default if it were to transfer the Asset and the transferor were to exercise the call option, or when the repurchase agreement or the total return swap settles. Alternatively, the transferee could transfer the Asset but arguably only by attaching the derivative to the Asset (ie the transferee would not be able to transfer the Asset in isolation). If the

derivative is a put option, the transferee appears to have the ability to transfer the Asset; however, the transferee may be unwilling to give up the value of the put option and thus economically be constrained from transferring the Asset in isolation (eg the put option might be sufficiently valuable to the transferee—whether that is the case will require judgement). As a result, the transferee is unlikely to have obtained control of the Asset (again, assuming that the derivative is not net settled). Accordingly, the transferor recognises a liability for the proceeds received and continues to recognise the Asset; the transferee recognises a receivable for the cash paid to the transferor.

(c) *Transfer of a financial asset with a subordinated interest in the asset*. As part of a transfer of a financial asset, a transferor may provide the transferee with credit enhancement by subordinating some or all of its interest retained in a transferred asset. For such transfers, 'the Asset' is the entire financial asset because the performance of the interest retained depends on that of the interest transferred. Through the interest retained and the subordination of that interest, the transferor has an interest in the future performance of the entire financial asset and thus has continuing involvement in the Asset. Also, because of the transferor's retained interest, the transferee will not have the practical ability to transfer the Asset to an unrelated third party for its own benefit. As a result, control of the Asset has not passed to the transferee. The transferor recognises a liability for the proceeds received and continues to recognise the Asset; the transferee recognises a receivable for the cash paid to the transferor.

(d) *Transfer of a financial asset with a subordinated interest in the entity to which the asset is transferred*. As part of a transfer of a financial asset, a transferor may provide the transferee with credit enhancement by purchasing a subordinated (residual) interest in the transferee. For such transfers, 'the Asset' is the entire financial asset because the transferor's remaining interest in the transferred financial asset (considering its interest in the transferee) is subordinated and, as a result, the performance of that subordinated interest is dependent on the net interest transferred. Through the interest retained and the subordination of that interest, the transferor has an interest in the future performance of the entire financial asset and thus continuing involvement in the Asset. Also, because of the transferor's retained interest, the transferee does not have the practical ability to transfer the Asset to an unrelated third party for its own benefit. As a result, control of the Asset has not passed to the transferee. The transferor recognises a liability for the proceeds received and continues to recognise the Asset; the transferee recognises a receivable for the cash paid to the transferor.

(e) *Transfer of a financial asset with a credit guarantee*. As part of a transfer of a financial asset, a transferor may provide the transferee with credit enhancement in the form of a credit guarantee that could be unlimited or limited to a specified amount. For such transfers, 'the Asset' is the entire financial asset. The guarantee represents continuing involvement by the transferor in the Asset because the guarantee is a new liability assumed by the transferor in connection with the transfer, and through the guarantee the transferor has a responsibility to make payments in respect of the Asset if the debtor underlying the Asset were to default. Whether the transferee has the practical ability to transfer the Asset to an unrelated third party for its own benefit (and hence whether the transferee has obtained control of the Asset) depends on whether the Asset is readily obtainable and, if it is not, on whether the guarantee economically constrains the transferee. If the Asset is readily obtainable, the transfer qualifies for derecognition (in which case the transferor derecognises, and the transferee recognises, the Asset and both recognise a credit guarantee). If the Asset is not readily obtainable and the guarantee economically constrains the transferee, the transfer does not qualify for derecognition (in which case the transferor recognises a liability for the proceeds received and continues to recognise the Asset; the transferee recognises a receivable for the cash paid to the transferor).

Issue of equity-linked note

(f) *Scenario A—Note not contractually linked to shares*. Entity A issues to Entity C a note for which the returns are linked to the performance of 10 per cent of Entity B's outstanding ordinary shares (ie Entity A will pay to Entity C 10 per cent of all interim and final distributions made by Entity B on Entity B's outstanding shares). According to the terms of the note, Entity A is not obliged to hold a 10 per cent investment in Entity B. However, although it is not obliged, Entity A invests in 10 per cent of Entity B's outstanding shares.

The issue by Entity A of the equity-linked note to Entity C does not qualify as a *transfer* of Entity A's 10 per cent investment in Entity B because Entity A is not obliged to remit to Entity C the economic benefits of its investment in Entity B. If Entity A were to sell its investment in Entity B to a third party, it would not be required to pass to Entity C the proceeds from the sale. Furthermore, the third party would receive all of the economic benefits of the investment in Entity B (ie distributions from Entity B would flow to the third party) and, as a result, there would be nothing for Entity A to remit to Entity C. In essence, Entity A has issued a note with an embedded derivative referenced to 10 per cent of the outstanding ordinary shares of Entity B. As a result, the issue of the note is not a transfer that is assessed for derecognition.

(g) *Scenario B—Note contractually linked to shares*. The facts are the same as in Scenario A except that:

(i) Entity C has a security interest in the shares that Entity A holds in Entity B;

(ii) Entity C agrees to look to only the cash flows from those shares for repayment of the note (ie Entity C has no recourse against Entity A);

(iii) Entity A is obliged to pass to Entity C all cash flows it receives from its 10 per cent investment in Entity B; and

(iv) Entity A is prohibited from selling the shares without the approval of Entity C.

In contrast to Scenario A, the issue by Entity A of the equity-linked note to Entity C qualifies as a *transfer* of Entity A's 10 per cent investment in Entity B because Entity A is obliged to pass to Entity C the economic benefits of its investment in Entity B. Entity A is prohibited from transferring the shares in Entity B and is required to forward to Entity C all distributions that it receives on those shares. Because it cannot transfer the shares, unlike Scenario A, those distributions could never flow to an entity other than Entity A (which then would have an obligation to pass them to Entity B). Entity C also has access to the economic benefits of the shares through its security interest.

'The Asset' is Entity A's 10 per cent investment in Entity B because even though Entity A did not transfer the shares to Entity C, it transferred the right to all the economic benefits that those shares generate (which is akin to transferring the shares themselves). The fact that Entity A has agreed to pass all economic benefits of the Asset to Entity C means that Entity A does not have an interest in the future performance of the Asset. Accordingly, Entity A has no continuing involvement in the Asset. As a result, Entity A has passed control of the Asset to Entity C. Entity A derecognises, and Entity C recognises, the Asset.

Transfer of a financial asset with a net-settled total return swap

(h) An entity transfers for CU100 a financial asset that has a five-year maturity and pays interest of CU10 on t0, t1…t5 and principal of CU100 at t5. After the transfer the transferee has physical custody of the asset. In connection with the transfer, the entity

enters into a net-settled total return swap with the transferee.

(i) *Scenario A—Swap with interim return payments*. On t1 and t2, the transferor pays to the transferee a return (say, LIBOR plus a credit spread) on the initial CU100 it received from the transferee. The transferee pays to the transferor the CU10 that the financial asset generates. Also on t2 (in addition to the cash flows relating to the transferee's CU10 payment and the transferor's LIBOR-based payment), the parties exchange cash equal to the difference between the fair value of the financial asset and CU100. If the fair value of the financial asset exceeds CU100, the transferee pays that excess to the transferor. Alternatively, if the fair value of the financial asset is less than CU100, the transferor pays that difference to the transferee.

The transfer qualifies for derecognition because even though the transferor has continuing involvement in the financial asset ('the Asset') after the transfer as a result of the derivative (swap), the transferee has the practical ability to transfer the Asset for its own benefit. This is because the transferee can transfer the Asset to a third party unilaterally and without having to impose any additional restrictions. Because the swap is net settled, the transferee does not have an obligation to deliver the Asset to the transferor upon settlement. The transferee has the ability to transfer the Asset 'for its own benefit' because it can use the full proceeds from any such subsequent transfer as it pleases (eg the transferee could transfer the Asset before the swap settles without having an obligation to return the proceeds to the transferor). The transferor derecognises, and the transferee recognises, the Asset and both recognise the total return swap as a derivative.

(ii) *Scenario B—Swap with interim return payments included in the settlement of the swap*. Same facts as in Scenario A, except that the interim return payments on the transferee's initial CU100 investment are included in the settlement price of the swap. On t1 and t2, the transferee pays to the transferor the CU10 that the financial asset generates. Also on t2, the parties exchange cash equal to the difference between the fair value of the financial asset and CU130 (different from the CU100 in Scenario A—the CU130 includes the interim return payments that the transferor made on t1 and t2 in Scenario A). Thus, if the fair value of the financial asset exceeds CU130, the transferee pays that excess to the transferor. Alternatively, if the fair value of the financial asset is less than CU130, the transferor pays that difference to the transferee.

The analysis and accounting outcome are the same as in Scenario A.

(iii) *Scenario C—Fully prepaid swap*. On t0, the transferor pays to the transferee CU100 (so on a net basis, the parties do not exchange cash on t0). On t1 and t2, the transferee pays to the transferor the CU10 that the financial asset generates. Also, on t2 the transferee pays to the transferor the fair value of the asset. The transferor does not have a security interest in the asset that the transferee has in its custody. Also, the transferee is not restricted from selling the asset to a third party.

The analysis and accounting outcome are the same as in Scenario A except that (in addition to derecognising the Asset) the transferor recognises as a financial asset its right to receive cash flows from the transferee on t1 and t2 (those cash flows are (a) the cash flows that the transferred (and derecognised) Asset generates on t1 and t2 and (b) the fair value of the Asset on t2)). The transferee would recognise a corresponding financial liability (in addition to recognising the

Asset).

(iv) *Scenario D—Fully prepaid swap with asset 'ring-fenced' (reverse pass-through).* Same facts as in Scenario C except that the transferor has a security interest in the asset transferred to the transferee on t0 (as a result, the transferee is prohibited from transferring the asset to a third party). The transferor has no rights to the transferee's other assets if the asset does not generate any cash flows. Also, the transferee could decide to settle its obligation to pass on any cash flows from the assets on t1 and t2 or pay the fair value of the asset on t2 by transferring the asset to the transferor.

The transfer fails derecognition. Through the swap, the transferor has continuing involvement in the financial asset transferred (the Asset) and the transferee is restricted from transferring the Asset for its own benefit. As a result, the transferor continues to recognise the Asset. (The transferor would not recognise a financial liability as a result of the failed sale because it would derecognise that liability in light of its CU100 payment to the transferee on t0. Similarly, the transferee would not recognise a financial asset because it would immediately derecognise that asset as a result of the receipt of CU100 from the transferor on t0.)

The heading before paragraph AG57 and paragraphs AG57–AG63 are amended (new text is underlined and deleted text is struck through). Paragraph AG62A is added.

Derecognition of a financial liability (paragraphs 39A–42B)

AG57 An entity shall derecognise a financial liability (or part of it) ~~is extinguished when~~ the if the present obligation is eliminated and the entity is no longer required to transfer economic resources in respect of that obligation. For example, a debtor would derecognise a financial liability (or part of it) if it either:

(a) discharges the liability (or part of it) by paying the creditor, normally with cash, other financial assets, goods or services; or

(b) ~~is~~ obtains a legal~~ly~~ release~~d~~ from primary responsibility for the liability (or part of it) either by process of law or ~~by~~ from the creditor~~.~~ (even ~~I~~if the debtor ~~has given a~~ guarantees the third party's obligation to the creditor ~~this condition may still be met.~~).

AG58 If an issuer of a debt instrument repurchases that instrument, ~~the debt is extinguished~~ it derecognises that liability (because it no longer has a present obligation to transfer economic resources to a third party) even if ~~the issuer~~ it is a market maker in that instrument ~~or intends to resell it in the near term~~.

AG59 Payment to a third party, including a trust (sometimes called 'in-substance defeasance'), does not, by itself, relieve the debtor of its ~~primar~~y obligation to the creditor, in the absence of a legal release.

AG60 If a debtor pays a third party to assume ~~an~~ its debt obligation and notifies its creditor that the third party has assumed ~~its debt~~ the obligation, the debtor does not derecognise the ~~debt obligation~~ associated liability unless the ~~condition in paragraph AG57(b) is met~~ creditor legally releases the debtor from the responsibility for the liability. If the debtor pays a third party to assume ~~an~~ its debt obligation and obtains a legal release from its creditor, the debtor ~~has extinguished the debt~~ no longer has a present obligation to transfer economic resources to the creditor and derecognises the associated liability. However, if the debtor also agrees to make payments on the debt to the third party or direct to its original creditor, the debtor recognises a new debt obligation to the third party.

AG61 ~~Although~~ Even though a legal release, whether judicially or by the creditor, results in derecognition of a liability, the entity may recognise a new liability if the derecognition criteria in paragraphs 15A~~–37~~18A are not met for the financial assets transferred. If those criteria are not met, the transferred assets are not derecognised, and the entity recognises a new liability relating to the transferred assets.

AG62 For the purpose of paragraph 40A, the original and renegotiated terms of a debt instrument are substantially different if the discounted present value of the cash flows under the ~~new~~ renegotiated terms, including any fees paid net of any fees received and discounted using the original effective interest rate, is at least 10 per cent different from the discounted present value of the remaining cash flows of the ~~original~~ financial liability under the original terms. ~~If an exchange of debt instruments or modification of terms is accounted for as an extinguishment, any costs or fees incurred are recognised as part of the gain or loss on the extinguishment. If the exchange or modification is not accounted for as an extinguishment, any costs or fees incurred adjust the carrying amount of the liability and are amortised over the remaining term of the modified liability.~~

AG62A The guidance in paragraph AG62 applies only to the extent the exchange or modification is not a transfer of a financial asset, as that term is defined in paragraph 9. For example, an entity might exchange a debt instrument with the creditor for a debt instrument that is similar in nature to the loan described in paragraph AG44A (ie the new debt instrument requires the entity to repay the loan (both principal and interest) only from proceeds generated by a specified financial asset in which the creditor has a security interest (or by the transfer of the asset itself) and then only to the extent that the asset generates sufficient funds). In that case, the entity analyses the new debt instrument as a transfer of the financial asset following the criteria in paragraphs 15A–18A. If the asset qualifies for derecognition, the entity derecognises it, and also derecognises the financial liability relating to the previous debt instrument.

AG63 In some cases, a creditor releases a debtor from its present obligation to make payments, but the debtor assumes a guarantee obligation to pay if the party assuming primary responsibility defaults. In th~~i~~ese circumstances the debtor:

(a) recognises a new financial liability based on the fair value of its obligation for the guarantee; and

(b) recognises a gain or loss based on the difference between (i) any proceeds paid and (ii) the carrying amount of the ~~original~~ previously recognised financial liability less the fair value of the ~~new financial liability~~ guarantee.

Proposed amendments to FRS 107 *Financial Instruments: Disclosures*

Paragraph 13 and the heading before paragraph 13 are deleted. After paragraph 42, headings and paragraphs 42A–42F are added.

Derecognition

42A The disclosure requirements in paragraphs 42B–42F relating to transferred financial assets supplement the other disclosure requirements of this FRS. An entity shall present the disclosures in paragraphs 42B and 42D–42F in a single note in its financial statements.

Derecognition—Transferred financial assets that are not derecognised

42B An entity may have transferred financial assets in such a way that part or all of the financial assets do not qualify for derecognition (see paragraphs 15A–18A of FRS 39). The entity shall disclose information that enables users of its financial statements to understand the relationship between those assets and associated liabilities after the transfer. The entity shall disclose for each class of such financial assets:

(a) the nature of the assets.

(b) the nature of the risks to which the entity remains exposed.

(c) the carrying amounts of the assets and of the associated liabilities.

(d) a description of the nature of the relationship between the assets and the associated liabilities, including any restrictions on the entity's use of the assets.

(e) when the counterparty (or counterparties) to the associated liabilities has (have) recourse only to the assets, a schedule that sets out the fair value of the assets, the fair value of the associated liabilities and the net position.

Derecognition—Transferred financial assets that are derecognised

42C When an entity derecognises financial assets but has continuing involvement in them (see paragraphs 15A–18A of FRS 39), the entity shall disclose information that enables users of its financial statements to evaluate the nature of and risks associated with the entity's continuing involvement in those derecognised financial assets.

42D To meet the objective in paragraph 42C, an entity shall disclose, as a minimum, for each category of continuing involvement at the reporting date:

(a) the carrying amount of the assets and liabilities recognised in the entity's statement of financial position representing the entity's continuing involvement, and the line items in which those assets and liabilities are recognised.

(b) the fair value of the assets and liabilities representing the entity's continuing involvement.

(c) the amount that best represents the entity's maximum exposure to loss from its continuing involvement, including how the maximum exposure to loss is determined.

(d) the fair value of derecognised financial assets in which the entity has continuing

involvement, including a description of the methods and assumptions applied in determining the fair value (see paragraphs 27A and 27B).

(e) the undiscounted cash outflows to repurchase derecognised financial assets (eg the strike price in an option agreement or the repurchase price in a repurchase agreement).

(f) a maturity analysis of the undiscounted cash outflows to repurchase the derecognised financial assets that shows the remaining contractual maturities of the entity's continuing involvement.

(g) a sensitivity analysis showing the possible effect on the fair value of the continuing involvement of changes in the relevant risk variables that were reasonably possible at the reporting date. The entity shall describe the methods and assumptions used in preparing the sensitivity analysis (see relevant sections of paragraphs B17–B21).

(h) qualitative information that explains and supports the quantitative disclosures in (a)–(g).

42E In addition, an entity shall disclose for each category of continuing involvement:

(a) the gain or loss recognised at the date of transfer of the assets.

(b) income and expenses recognised from the entity's continuing involvement (eg servicing fees and fair value changes in derivative instruments).

(c) if the total amount of transfer activity (that qualifies for derecognition) in a reporting period is not evenly distributed throughout the reporting period (eg if a substantial proportion of the total amount of transfer activity takes place in the closing days of a reporting period), the total amount of the transfer activity and the related gains or losses recognised in the period within the reporting period that has the greatest transfer activity. The entity shall also disclose when (within a reporting period) the greatest transfer activity took place (eg the last five days before the end of the reporting period).

An entity shall provide this information for each of the periods for which a statement of comprehensive income is presented.

42F An entity shall disclose any additional information that it considers necessary to meet the disclosure objective in paragraph 42C.

Effective date and transition

Paragraph 44H is added.

44H *Derecognition* (Amendments to FRS 39 and FRS 107), issued in [month and year], deleted paragraph 13 and added paragraphs 42A–42F. An entity shall provide the disclosures required by those paragraphs for transactions entered into after [date, which is the effective date of the amendments to FRS 39 resulting from *Derecognition* (Amendments to FRS 39 and FRS 107), issued in [month and year]]. However, if the entity elects to apply those amendments to FRS 39 before [date specified above], it shall provide the added disclosure requirements for all transactions from that earlier date. If an entity derecognised financial assets or financial liabilities in accordance with FRS 39 (revised 2003) as a result of a transaction entered into before [date specified above] or, if applicable, the earlier date from which the entity elected to apply the amendments to FRS 39 resulting from *Derecognition* (Amendments to FRS 39 and FRS 107), issued in [month and year], and those assets or liabilities would not have been derecognised in accordance with FRS 39 [as proposed to be amended], it shall provide the disclosures required by paragraphs 42C–42F. If, in accordance with FRS 39 (revised 2003), an entity did not derecognise

financial assets or financial liabilities as a result of a transaction entered into before [date specified above] or, if applicable, the earlier date from which the entity elected to apply the amendments to FRS 39 resulting from *Derecognition* (Amendments to FRS 39 and FRS 107), issued in [month and year], and those assets or liabilities would have been derecognised in accordance with FRS 39 [as proposed to be amended], it shall provide the disclosures required by paragraph 42B.

Appendix B
Application guidance

After paragraph B28, headings and paragraphs B29-B34 are added.

Derecognition (paragraphs 42A–42F)

Categories of continuing involvement (paragraphs 42D and 42E)

B29 Paragraphs 42D and 42E require qualitative and quantitative disclosures for each category of continuing involvement. An entity classifies its continuing involvement into categories that are representative of the entity's exposure to risks. For example, an entity may categorise its continuing involvement by type of continuing involvement (eg repurchase agreements, guarantees, call options and servicing) or by type of transfer (eg factoring, receivables securitisations and securities lending).

Maturity analysis for undiscounted cash outflows to repurchase transferred assets (paragraph 42D(f))

B30 Paragraph 42D(f) requires an entity to disclose a maturity analysis of the undiscounted cash outflows to repurchase derecognised financial assets, which shows the remaining contractual maturities of the entity's continuing involvement (eg the strike price in an option agreement or the repurchase price in a repurchase agreement). This analysis distinguishes cash flows that are required to be paid (eg forward contracts), cash flows that the entity may be required to pay (eg written put options) and cash flows that the entity might choose to pay (eg purchased call options).

B31 An entity uses its judgement to determine an appropriate number of time bands in preparing the maturity analysis required by paragraph 42D(f). For example, an entity might determine that the following time bands are appropriate:

(a) not later than one month;

(b) later than one month and not later than three months;

(c) later than three months and not later than one year; and

(d) later than one year and not later than five years.

B32 If there is a range of possible maturities, the cash flows are included on the basis of the earliest date on which the entity can be required or permitted to pay.

Qualitative information (paragraph 42D(h))

B33 The qualitative information required by paragraph 42D(h) includes a description of the derecognised financial assets, and the nature and purpose of the continuing involvement retained after transferring those assets. It also includes a description of the risks to which an entity is exposed, including:

(a) a description of how the entity manages the risk inherent in its continuing involvement.

(b) whether the entity is required to bear losses before other parties, and the ranking and amounts of losses borne by each category of party involved.

(c) a description of triggers associated with obligations to provide financial support or to repurchase a transferred financial asset.

Gain or loss on derecognition (paragraph 42E(a))

B34 Paragraph 42E(a) requires an entity to disclose the gain or loss on derecognition relating to financial assets in which the entity has continuing involvement. The entity shall indicate if a gain or loss on derecognition arose because the fair values of the components of the previously recognised asset (ie the interest in the asset derecognised and the interest retained by the entity) were different from the fair value of the previously recognised asset as a whole. In that situation, the entity also discloses the extent to which the fair value calculations were dependent on Level 3 inputs in paragraph 27A of FRS 107 (as amended in April 2009).

Amendments to other FRSs

The amendments below shall be applied to transactions entered into after [date]. If an entity applies [draft] Derecognition *to transactions entered into earlier than [date], these amendments shall be applied from that earlier date. Amended paragraphs are shown with new text underlined and deleted text struck through.*

Proposed amendments to FRS 101 *First-time Adoption of Financial Reporting Standards* (as revised in 2008)

Presentation and disclosure

Paragraph 20A is added.

20A An entity shall provide the disclosures required by paragraphs 42A–42F of FRS 107 *Financial Instruments: Disclosures* for transactions entered into after [date] or, if applicable, the earlier date from which the entity elected to apply the derecognition requirements of FRS 39, as permitted by paragraph B2 of this FRS. If an entity derecognised financial assets or financial liabilities in accordance with its previous GAAP as a result of a transaction entered into before [date] or, if applicable, the earlier date from which the entity elected to apply the requirements, and those assets or liabilities would not have been derecognised in accordance with FRS 39, it shall provide the disclosures required by paragraphs 42C–42F of FRS 107. If, in accordance with its previous GAAP, an entity did not derecognise financial assets or financial liabilities in accordance with its previous GAAP as a result of a transaction entered into before [date] or, if applicable, the earlier date from which the entity elected to apply the requirements, and those assets or liabilities would have been derecognised in accordance with FRS 39, it shall provide the disclosures required by paragraph 42B of FRS 107.

Appendix B
Exceptions to retrospective application of other FRSs

Paragraphs B2 and B3 are amended (new text is underlined and deleted text is struck through).

Derecognition of financial assets and financial liabilities

B2 Except as permitted by paragraph B3, a first-time adopter shall apply the derecognition requirements in FRS 39 *Financial Instruments: Recognition and Measurement* prospectively ~~for~~ to transactions ~~occurring~~ entered into on or after ~~1 January 2004~~ [date]. ~~In other words,~~ Accordingly:

(a) if a first-time adopter derecognised non-derivative financial assets or non-derivative financial liabilities in accordance with its previous GAAP as a result of a transaction ~~that occurred~~ entered into before ~~1 January 2004~~ [date specified above] or, if applicable, the date from which the entity elected to apply the requirements, it shall not recognise those assets and liabilities in accordance with FRSs (unless they qualify for recognition as a result of a later transaction or event).

(b) if, in accordance with its previous GAAP, a first-time adopter did not derecognise financial assets or financial liabilities as a result of a transaction entered into before [date specified above] or, if applicable, the earlier date from which the entity elected to apply the requirements, it shall not derecognise those assets or liabilities in accordance with FRSs (unless they qualify for derecognition as a result of a later transaction or event).

B3 Notwithstanding paragraph B2, an entity may apply the derecognition requirements in FRS 39 ~~retrospectively~~ prospectively to transactions entered into ~~from a~~ before the date ~~of the entity's choosing~~ specified in paragraph B2, provided that the entity obtained the information needed to apply FRS 39 to financial assets and financial liabilities derecognised as a result of past transactions ~~was obtained~~ at the time ~~of~~ it initially account~~ing~~ed for those transactions. If an entity elects to apply the derecognition requirements in FRS 39 prospectively to transactions entered into before the date specified in paragraph B2, it shall disclose that fact, and it shall apply the requirements to *all* transactions from that date.

Proposed amendment to FRS 104 *Insurance Contracts*

Recognition and measurement

Temporary exemption from some other FRSs

Paragraph 14(c) is amended (new text is underlined and deleted text is struck through).

14 Nevertheless, this FRS does not exempt an insurer from some implications of the criteria in paragraphs 10–12 of FRS 8. Specifically, an insurer:

(a)–(b) …

(c) shall ~~remove~~ derecognise an insurance liability (or a part of ~~an insurance liability~~ it) ~~from its statement of financial position when, and only when, it is extinguished—ie when the obligation specified in the contract is discharged or cancelled or expires~~ (or the part) no longer qualifies as a liability of the insurer. An insurance liability ceases to qualify as a liability of the insurer if the present obligation is eliminated and the insurer is no longer required to transfer economic resources in respect of that obligation.

Proposed amendment to
FRS 32 *Financial Instruments: Presentation*

Presentation

Offsetting a financial asset and a financial liability (see also paragraphs AG38 and AG39)

Paragraph 42 is amended (new text is underlined and deleted text is struck through).

42 **…**

In accounting for a transfer of a financial asset that does not qualify for derecognition, the entity shall not offset the transferred asset and the associated liability (see FRS 39 paragraph ~~36~~23A).

Proposed amendments to guidance on implementing FRSs

Proposed amendments to guidance on implementing FRS 39 *Financial Instruments: Recognition and Measurement*

Section B Definitions

The answer to Question B.32 is amended (new text is underlined and deleted text is struck through).

B.32 Recognition and derecognition of financial liabilities using trade date or settlement date accounting

FRS 39 has special rules about recognition and derecognition of financial assets using trade date or settlement date accounting. Do these rules apply to transactions in financial instruments that are classified as financial liabilities, such as transactions in deposit liabilities and trading liabilities?

No. FRS 39 does not contain any specific requirements about trade date accounting and settlement date accounting in the case of transactions in financial instruments that are classified as financial liabilities. Therefore, the general recognition and derecognition requirements in FRS 39.14 and FRS 39.39A apply. FRS 39.14 states that financial liabilities are recognised on the date the entity 'becomes a party to the contractual provisions of the instrument'. Such contracts generally are not recognised unless one of the parties has performed or the contract is a derivative contract not exempted from the scope of FRS 39. FRS 39.39A specifies that financial liabilities are derecognised only when they ~~are extinguished, ie when the obligation specified in the contract is discharged or cancelled or expires~~ no longer qualify as a liability of the entity, ie when the present obligation is eliminated and the entity is no longer required to transfer economic resources in respect of that obligation.

Proposed amendments to guidance on implementing FRS 101 *First-time Adoption of Financial Reporting Standard*

FRS 39 *Financial Instruments: Recognition and Measurement*

Paragraph IG52 is reproduced for ease of reference. Paragraphs IG53 and IG54 are amended (new text is underlined and deleted text is struck through).

IG52 An entity recognises and measures all financial assets and financial liabilities in its opening FRS statement of financial position in accordance with FRS 39, except as specified in paragraphs B2–B6 of the FRS, which address derecognition and hedge accounting.

Recognition

IG53 An entity recognises all financial assets and financial liabilities (including all derivatives) that qualify for recognition under FRS 39 and have not yet qualified for derecognition in accordance with FRS 39, except non-derivative financial assets and non-derivative financial liabilities derecognised in accordance with previous GAAP as a result of a transaction entered into before ~~1 January 2004~~ [date], to which the entity does not choose to apply paragraph B3 (see paragraphs B2 and B3 of the FRS). For example, an entity that does not apply paragraph B3 does not recognise non-derivative financial assets transferred in a securitisation, transfer or other derecognition transaction entered into ~~that occurred~~ before ~~1 January 2004~~ [date] if those transactions qualified for derecognition in accordance with previous GAAP. However, if the entity uses the same securitisation arrangement or other derecognition arrangement for further transfers after ~~1 January 2004~~ [date], those further transfers qualify for derecognition only if they meet the derecognition criteria of FRS 39.

IG54 An entity does not recognise financial assets and financial liabilities that do not qualify for recognition in accordance with FRS 39, or have already qualified for derecognition in accordance with FRS 39 (unless they are derivative assets or liabilities that qualify for recognition in accordance with FRS 39).

Proposed amendments to guidance on implementing FRS 107 *Financial Instruments: Disclosures*

After paragraph IG40 a heading and paragraph IG40A are added.

Derecognition (paragraph 42A–42F)

IG40A The following examples illustrate some possible ways to meet the quantitative disclosure requirements relating to derecognition in FRS 107.

Transferred financial assets that are not derecognised

Illustrating the application of paragraph 42B(c) and (e)

	Class of financial asset				
	Financial assets at fair value through profit or loss		**Loans and receivables**		**Available-for-sale financial assets**
CU million	Trading securities	Trading derivatives	Mortgages	Consumer loans	Equity investments
Carrying amount of assets	X	X	X	X	X
Carrying amount of associated liabilities	(X)	(X)	(X)	(X)	(X)
For those liabilities that have recourse only to specific assets:					
Fair value of assets	X	X	X	X	X
Fair value of associated liabilities	(X)	(X)	(X)	(X)	(X)
Net position	X	X	X	X	X

Transferred financial assets that are derecognised

Illustrating the application of paragraph 42D(a)–(e)

Continuing involvement with transferred financial assets that have been derecognised						
CU million	Fair value of transferred (derecognised assets)	Cash outflows to repurchase transferred derecognised assets)	Carrying amount of Continuing involvement in statement of financial position		Fair value of continuing involvement	Maximum exposure to loss
Type of continuing involvement			Assets	Liabilities		
Repurchase agreements	X	(X)	X	(X)	X	X
Written put options	X	(X)		(X)	X	X
Purchased call options	X	(X)	X		X	X
Securities lending	X	(X)	X	(X)	X	X
Servicing	X		X	(X)	X	X
Total			X	(X)	X	X

Carrying amount of continuing involvement in the statement of financial position		
CU million	Total	
Class of asset or liability	Assets	Liabilities
Held for trading	X	
Available-for-sale financial assets	X	
Financial liabilities at fair value through profit or loss		(X)
Total	X	(X)

Illustrating the application of paragraph 42D(f)

Undiscounted cash flows to repurchase transferred assets							
CU million	Maturity of continuing involvement						
Type of continuing involvement	Total	<1 month	<3 month	<6 month	<1 years	1–2 years	>2 years
Repurchase agreements	X	X	X	X	X	X	
Written put options	X		X	X	X	X	
Purchased call options	X			X	X	X	X
Securities lending	X	X	X				