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Berlin, 13 July 2009

Dear Stig,

EFRAG Draft Comment Letter on IASB Exposure Draft ED/2009/3 'Derecognition – Proposed amendments to IAS 39 and IFRS 7'

On behalf of the German Accounting Standards Board (GASB) I am writing to comment on EFRAG's draft comment letter on the IASB Exposure Draft ED/2009/3 '*Derecognition – Proposed amendments to IAS 39 and IFRS 7*'. We appreciate the opportunity to comment on EFRAG's draft comment letter.

The GASB does not support the proposed new derecognition approach because it is not seen as an improvement in accounting or as a simplification in applying the derecognition test. We support the alternative approach as a starting point for a possible solution to obtain a better derecognition model. Therefore we do not agree with EFRAG's position that the IASB's work on derecognition should for the time being address financial crisis-related issues only. The derecognition project is a long-term project whereas the financial crisis only led to the acceleration of its final phase.

For the detailed comments we refer to our comment letter to the International Accounting Standards Board's Exposure Draft, which we attach to this letter.

If you would like to discuss any aspects of this comment letter in more detail, please do not hesitate to contact me.

Yours sincerely,

Liesel Knorr
President

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Sir David Tweedie
Chairman of the
International Accounting Standards Board
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Berlin, 13 July 2009

Dear David,

Exposure Draft ED/2009/3 Derecognition – Proposed amendments to IAS 39 and IFRS 7

On behalf of the German Accounting Standards Board (GASB) I am writing to comment on the IASB Exposure Draft ED/2009/3 'Derecognition – Proposed amendments to IAS 39 and IFRS 7' (herein referred to as 'ED'). We appreciate the opportunity to comment on the Exposure Draft.

The GASB does not support the proposed new derecognition approach in the Exposure Draft. Overall, in comparison to the current requirements we do not see the proposed approach as an improvement in accounting or as a simplification in applying the derecognition test. Furthermore, we believe that the proposed additional disclosures do not provide incremental benefit.

The GASB supports the alternative approach as a starting point for a new derecognition model. For a complete evaluation however, the basic concept presented needs further elaboration.



Please find our detailed comments on the questions raised in the ED in the appendix to this letter. If you would like to discuss our comments further, please do not hesitate to contact me.

Yours sincerely,

Liesel Knorr
President



Appendix

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?

We agree with the proposal that the assessment of ‘the Asset’ and ‘continuing involvement’ should be made at the level of the reporting entity.

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

Do you agree with the criteria proposed in paragraph 16A for what qualifies as the item (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 IAS 39.)

We agree that certain criteria are necessary to determine what represents ‘the Asset’ to be assessed for derecognition. Using criteria already in place in the current standard has merits. We understand that despite of the different wording the criteria proposed should be the same as those in IAS 39. We have also learned that the ‘or’ in paragraph 16A of the ED means actually ‘and/or’, i.e. a proportionate share of specifically identified cash flows from a financial asset also qualifies as ‘the Asset’. We suggest clarifying this point to avoid confusion when the standard is translated into other languages.

However, the GASB has concerns about the notion in paragraph 16A of the ED that the performance of the part retained does not depend on the performance of the part transferred, and vice versa, on the grounds set out by the dissenting Board members in AV 12 of the ED.



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?

It is the GASB’s understanding of the IASB’s objective that all transactions, irrespective of their form, should be assessed for derecognition when they are economically transfers of financial assets and therewith introducing a broader definition of a transfer. However, we believe that the proposed definition is too wide to achieve this objective in an adequate and efficient manner. For example the term ‘*agrees to pass*’ raises questions regarding the point in time at which the derecognition test is to be performed.

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?

One of the main criticism of the existing derecognition requirements in IAS 39 relates to continuing involvement. It is our understanding that this issue currently causes the most problems in practice. Thus, the GASB believes that retaining a continuing involvement test in a new derecognition model will not lead to a major improvement.



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 IAS 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?

The GASB does not agree with the proposed ‘practical ability to transfer’ derecognition test as we believe that the underlying criterion of this control test is not the essential one. An entity controls an asset when it has access to the future economic benefits embodied in that asset and has the ability to restrict others’ access to those future cash inflows. We believe that control is better evidenced by looking at who has the risks and rewards inherent in the asset rather than focusing on the ability to transfer the asset. The ability to restrict others’ access is more important than transferability. In a case where a portfolio of financial assets is transferred to a third party and the third party is contractually precluded from selling the assets in order to keep the assets’ market price stable, the proposed control test would fail and the assets would still be recognized by the transferring entity even though the third party receives all future cash flows. We do not believe that this is an appropriate outcome.

Another concern is the treatment of sale and repurchase agreements (repo transactions) involving readily obtainable securities which will represent sales of the transferred assets under the proposed derecognition model, in contrast to the current requirements where those have been treated as secured borrowings. The GASB is of the opinion that those transactions in substance are not sales and therefore a treatment as secured borrowings is more appropriate.



Finally we struggle with the proposed reassessment of the ‘practical ability to transfer’ test in AG52F and AG52G of the ED. We see practical problems in a subsequent assessment to be performed by the transferring entity but from a transferee’s perspective, when the transferring entity cannot obtain the necessary information at a later date.

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 IAS 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.)

We agree with the proposed accounting set out in paragraph 21A of the ED. We have reservations regarding the proposal in paragraph 22A of the ED. Firstly, in our view it is not clear which kind of entities the transferor has an interest in that the IASB has in mind. Secondly, the GASB believes that the purchased interest represents a new asset with a different risk and cash flow profile because the transferee entity comprises not only the transferred assets. Therefore this new asset should be accounted for following the general requirements rather than applying the proposed split.



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?

The GASB does not agree with establishing the derecognition model proposed in the ED as the new approach for determining derecognition of financial assets. We are not convinced that the proposal will be a major improvement or simplification compared to the existing requirements.

Regarding the alternative approach set out in the alternative views, we believe that this might be the starting point for a possible solution to obtain a better derecognition model that is less complex in application. However, as the alternative views contain the rough basic concept only, it is difficult to draw a final conclusion. The GASB is of the opinion that the alternative approach leads to an appropriate outcome in cases of transferring disproportionate shares of the cash flows from financial assets, because the retained parts have different risk profiles and thus represent new assets (or liabilities) to be recognised at fair value. A weakness of the approach is seen in cases where only a small proportionate share (e.g. 1% or 2%) of the cash flows from a financial asset is transferred and the financial asset is carried at amortised cost in the financial statements. Derecognising the ‘old’ asset and recognising the ‘new’ asset (representing 99% or 98% of the ‘old’ asset) at fair value offers structuring opportunities. A suggestion to avoid this problem would be to incorporate ‘the Asset’ test from the proposed approach in the ED into the alternative approach. Therefore, in the example mentioned, the derecognition test would only be applied on the 1% or 2% transferred cash flows while the retained part is still carried at cost.



Question 8 – Interaction between consolidation and derecognition

In December 2008, the Board issued an exposure draft ED 10 *Consolidated Financial Statements*. As noted in paragraphs BC28 and BC29, the Board believes that its proposed approach to derecognition of financial assets in this exposure draft is similar to the approach proposed in ED 10 (albeit derecognition is applied at the level of assets and liabilities, whereas consolidation is assessed at the entity level). Do you agree that the proposed derecognition and consolidation approaches are compatible? If not, why? Should the Board 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 the Board were to consider adopting the alternative approach, do you believe that that approach would be compatible with the proposed consolidation approach?

The GASB acknowledges the efforts of the IASB to arrive at compatible approaches for derecognition and consolidation as we emphasise the importance of internal consistency of IFRS standards. However, as stated in our answer to Question 5, we do not agree with the focus on transferability in determining control for derecognition purposes. In our opinion the ability to restrict others from access to the future economic benefits of an asset plays the important role and thus control can be better evidenced by looking at the risks and rewards inherent in the asset. The GASB already expressed this opinion consistently in its comment letter dated 23 March 2009 on the Exposure Draft ED 10 ‘Consolidated Financial Statements’.

Question 9 – Derecognition of financial liabilities

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

The IASB decided to amend the derecognition approach for financial liabilities currently in IAS 39 to more closely align it with the definition of a liability in the framework. It is our understanding, based on the feedback received, that this amendment will not result in a different treatment regarding derecognition of financial



liabilities in any case. This might raise the question of the rationale behind such an amendment. Assuming our understanding is correct, the GASB has no reservations about the proposed amendment.

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?

The GASB agrees with the proposed prospective application of a new derecognition model given the practical problems a retrospective application in this area would raise otherwise.

Question 11 - Disclosures

Do you agree with the proposed amendments to IFRS 7? If not, why? How would you propose to amend those requirements instead, and why?

One area of weakness in financial reporting unfolded by the global financial crisis relates to off balance sheet risks and insufficient disclosure about exposure to such risks. Therefore, the GASB fully understands that the proposed amendments to IFRS 7 are aimed at addressing those concerns. However, we believe that the proposed additional disclosures go much further than that. The GASB thinks that it is questionable whether the additional disclosures will be an improvement for users of financial statements. In our opinion, most of the disclosures relating to risks the entity is exposed to are already required under existing IFRS 7. We do not see the improvement in repeating these disclosures for a subset of transactions, those related to transfers; preparing those disclosures will put an additional burden on the preparers.



An inconsistency in this respect is the above mentioned treatment of repo transactions which will result in additional disclosures. If an entity purchases a corresponding derivative instead, similar disclosures will not be required for assets previously not on hand but which the entity has now in form of a net position.