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24<sup>th</sup> July 2009

## Response to ED on Derecognition

Dear Christian,

Thank you for your excellent presentation on the ED on Derecognition at our May Accounting Advocacy Committee meeting. We appreciated the opportunity to discuss the draft with you and your colleagues and we are pleased to provide some broad comments on the paper. Our comments are not based on a survey of the society's membership. On reflection, the committee determined that it would not be appropriate to survey members for their opinion as the committee could not easily identify the questions that it might put to members.

As you know, the CFA Society of the UK (CFA UK) represents the interests of more than 8,500 leading members of the UK investment profession. The society, which was founded in 1955, is one of the largest member societies of CFA Institute and is committed to leading the development of the investment profession through the promotion of the highest ethical standards and through the provision of continuing education, advocacy, information and career support on behalf of its members.

The society's advocacy activities are directed by the Accounting Advocacy and Investment Profession Advocacy committees which are wholly composed of CFA UK members working in the investment profession. CFA UK supports the CFA, Associate (ASIP) and IMC designations. Most members hold either the Chartered Financial Analyst (CFA), or Associate designation. CFA Institute is best known for developing and administering the CFA Program curriculum and examinations and issuing the CFA Charter. CFA Institute's mission is to lead the investment profession globally by setting the highest standards of ethics, education and professional excellence.

Most CFA UK members also belong to the CFA Institute and reaffirm annually their adherence to its Code of Ethics and Standards of Professional Conduct. Both CFA UK and CFA Institute are committed to providing members with a wide range of continuing education opportunities. All members are encouraged to undertake ongoing post-qualification continuing education.

In addition, CFA UK is the awarding body for the IMC, the benchmark entry-level qualification for those working in investment management in the UK. The examination is accredited by the Qualifications and Curriculum Authority (QCA) and is designated a recommended examination by the Financial Services Skills Council (FSSC) for the purposes of the Financial Services Authority's training and competence requirements. The IMC is held by more than 15,000 investment professionals.

## Feedback on derecognition

The committee notes the IASB and FASB's intention to deliver potentially converged standards on derecognition and agrees that the current requirements are complex and inconsistent. The committee understands that derecognition is a heightened concern for standard-setters and policy-makers in light of the financial crisis and the criticisms aimed at the lack of transparency in the accounting of securitised transactions. The committee appreciates the Board's focus on this issue.

However, the committee is concerned that the proposed approach may not necessarily result in more appropriate financial reporting. Moving from a determination based on several concepts (risk and rewards, control and continuing involvement) to a single concept (control) is appealing as it would parallel the approach for the recognition of assets and appears easier to understand and apply. Nevertheless, the proposed approach retains complexities of its own in the shape of the continuing involvement and practical ability to transfer tests. The committee also notes the reliance, in part, on the concept of 'readily obtainable financial assets'. The committee worries that the obtainability of assets will change over time and that may lead to inconsistency in accounting.

The committee acknowledges that the Board's difficulty in arriving at a proposed approach partly stems from philosophical debates about the nature of financial assets (their divisibility into separate assets) and the substance of transactions. As the ED points out in BC 66, the lack of agreement in this area means that 'any accounting method chosen will be criticised for not reflecting the substance of the transaction'. That item continues 'Another difficulty adding to the controversy is the disagreement about how the *Framework* should be applied to a transfer transaction to determine whether the asset qualifies for derecognition'. Given that these are significant issues, would it not have been preferable to deal with derecognition through a discussion paper, rather than an exposure draft? Doing so would also have provided the Board with an opportunity to extend its description of the alternative approach and to spend more time talking to preparers and users about the potential impact of changes on the accounting for repo transactions.

The committee believes that more time should be spent in developing standards for derecognition and does not believe that the proposed approach will result in better financial reporting. The committee prefers – in principle – the alternative approach.

The alternative approach is summarized as follows in BC 67:

'Under the alternative approach, an entity derecognises a financial asset if it no longer controls all the economic benefits of the asset. An implication of that approach is that if an entity transfers part of a financial asset, it generally will derecognise the previously recognised asset and will recognise as a new asset the economic benefits retained. The retained economic benefits are treated as a new asset because their characteristics typically differ from those embodied in the previously recognised asset. Consistently with the other requirements in IAS 39, the new asset would be measured at fair value and any gain or loss resulting from the transfer would be recognised in profit or loss.'

Compare that statement with the proposed approach summarized as follows in BC 68:

'An entity derecognises a financial asset or a part of it if it relinquishes control of the asset or the part (provided the part is of a type that the proposed approach permits to be derecognised). The entity assesses control after it determines that it has continuing involvement in the transferred asset or the part after the transfer. To the extent that the entity has relinquished control of (and derecognises) the part transferred, it allocates the carrying amount of the underlying asset between the part transferred and the part retained on the basis of the relative fair value of those parts. The entity accounts for the part retained as a part of the asset recognised before the transfer. Thus, it applies to the part the same measurement attribute that it previously used for the entire asset.'

The committee agrees that the alternative approach has weaknesses, but believes that these are outweighed by its relative simplicity and apparent logic relative to the proposed approach.

Last, the committee notes that both the proposed approach and the alternative approach would lead to significant changes in the accounting of repurchase agreements (repos). The committee is not aware that there were concerns among users or preparers in relation to the accounting for repos. Equally, as these transactions are commonly regarded as financing transactions and not as transfers it is debatable that they should be captured within the proposed standards.

Thank you again for your presentation to the committee. We hope that these comments have been useful and would be pleased to provide additional feedback in future.

Yours,

Jane Fuller, Chair Accounting Advocacy Committee

Will Goodhart, Chief Executive