IASB
30 Cannon Street
London EC4M 6XH
UK
Paris, July 28, 2009

Re: Derecognition – Proposed amendments to IAS 39 and IFRS 7

Dear Sir or Madam,

MAZARS welcomes the opportunity to comment on the IASB Proposed amendments to IAS 39 and IFRS 7 – Derecognition. Our answer to the exposure draft questions are shown in the appendix to this letter which summarises our concerns and opinion.

We were pleased to attend to the roundtables on derecognition and ED 10 which took place on the 15th and 16th of July in London. In our below comments we paid attention to comply with the Board recommendation, expressed during these roundtables, to illustrate our position with practical examples.

We welcome the Board’s intention to move towards simplification of the current derecognition approach. We strongly support the Board regarding the suppression of the current continuing involvement approach (i.e. partial derecognition) and the clarification on normal representation and warranties analysis.

We note that the current derecognition approach is now well understood and consistently applied. Moreover, it has not shown any major flaw in the recent context of turmoil on the financial markets. We therefore consider that any significant amendment to the current approach should be submitted to an in depth field testing in order to demonstrate that the proposed modifications result in an improvement compared to the present situation.

Thus, we do not recommend the Board to adopt the proposed approach because it leads to accounting outcomes which do not reflect the economic reality of the transaction. Below are two examples:

- We consider that the fair representation of Repurchased agreement (Repo) is a collateralised debt, without derecognition of the asset since the transferor retains all of its risks and rewards. The proposed approach’s outcome on Repo transaction is to derecognise the transferred asset.
We consider that the fair representation of a commercial receivables transfer through a factoring process is to derecognise the transferred assets as the transferor retains generally no, or very few, of its risks and rewards. The proposed approach’s outcome for this kind of transaction is a collateralised debt without derecognition of the transferred asset.

We believe that these counter-intuitive outcomes are the consequence of two major flaws embedded in the proposed approach.

Firstly, we consider that the proposed approach does not give sufficient weight to the risks and rewards analysis:

- We consider that an entity should not derecognise an asset, even if it is readily obtainable, if consequently to the transfer it has retained substantially all of its risks and rewards. Example AG52L(a) and AG52L(g) of the exposure draft lead both to derecognition although in the first one the entity transfers no or very few risks and rewards, and in the latest the entity transfers substantially all risks and rewards. We consider that these situations are economically very different and should therefore not lead to the same accounting treatment.

- We consider that the focus on the control analysis to the detriment of the risks and rewards analysis will create structuring opportunities. Moreover, it has not been demonstrated that an approach mainly based on a control analysis provides more relevant accounting outcome than the current IAS 39 approach.

Secondly, we disagree with a control analysis performed from the transferee point of view for the following reasons:

- We acknowledge that the proposed approach is similar to the current IAS 39 rule mentioned in paragraph 20(c)(i) and 23. But very little practice has been developed on this control test as the current approach is mainly focused on a risks and rewards analysis. We consider that an approach focused on this control analysis without a prior risks and rewards filter could result in an accounting treatment which does not reflect appropriately the economic reality of the transaction. We therefore disagree with the implementation of the proposed approach without prior in depth field testing.

- The control analysis performed from the transferee point of view raises significant practical issues. If the transferor is able to assess the ability of the transferee to dispose of the transferred asset in view of the constraints detailed in the transfer's contract, he is generally not able to identify any other constraints faced by the transferee (such as tax or regulatory constraints).

- We consider that the sale of an instrument is not the only way to generate economic benefit from an asset. In the case of a distressed asset bought in the secondary market with a significant discount, the entity could earn significant benefits if the effective recovery rate is higher than expected. The fact that the entity is prohibited from selling the asset does not preclude its capacity to access the economic benefits of the asset.
As a consequence, the control approach developed in the exposure draft based on “the transferee ability to transfer the asset” (paragraph 17A) seems flawed to us.

Given the several concerns mentioned above, and having in mind the timing constraints faced by the Board, we recommend to the Board to adopt a 2 steps process:

Step 1: In the short term: keep the current IAS 39 approach with the following amendments to:

- abandon any partial derecognition outcome (current continuing involvement approach)
- deal explicitly with « normal representation and warranties » as proposed in paragraph 18A(a) of the exposure draft (please refer to our answer to question 4)
- add disclosure where necessary on the basis of the recent financial crisis experience

Step 2: In the mid term, develop a new derecognition approach taking into consideration the transfer of substantially all risks and rewards. This approach should be confirmed by extensive field testing.

Our detailed answers are set out in the Appendix.

Do not hesitate to contact us should you wish to discuss our comments.

Best regards,

Michel Barbet-Massin

Head of Financial Reporting Technical Support
APPENDIX

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

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

Yes we agree that the analysis should be performed at the level of the reporting entity.

Please refer to our answer to question 8 regarding the interaction between the proposed derecognition approach and the exposure draft ED 10 Consolidated financial statement.

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

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

Yes we agree.

Nevertheless, compared to present IAS 39, we note that the exposure draft deleted the reference to a « group of similar financial assets ». We are unsure whether this reflects a positive intention of the Board. We consider that the Board should add further basis for conclusion on this modification to help understand its rational.

Without clarification, this deletion, combined with paragraph AG42A, could be interpreted in two different ways:

View A: the analysis can be performed on a group of non similar transferred financial asset (i.e. it is still possible to split the whole transfer into groups of similar assets in order to perform the analysis)

View B: the analysis shall be performed on the transfer (i.e. globally on the group of transferred financial asset either similar or not).

Below is a practical example in which the two views lead to different accounting treatment:

Example: a corporate entity agrees with a counterparty to transfer a portfolio of commercial receivables. 30% of the transferred assets are denominated in a foreign currency. The remaining 70% are denominated in the transferor’s functional currency. The transferor transfers all the risks and rewards and retains no continuing involvement in the transferred portfolio except the foreign currency risk.
The table below presents the analysis outcome depending on whether View A or View B is retained.

<table>
<thead>
<tr>
<th>Example</th>
<th>View A</th>
<th>View B</th>
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|         | The analysis is performed separately on two parts of the portfolio:  
  - The 70% denominated in the transferor functional currency are derecognised at the continuing involvement step (§17A(b)).  
  - The analysis is performed separately for the receivables denominated in a foreign currency | As the analysis shall be performed on the global portfolio, no receivables can be derecognised at the continuing involvement step (§17A(b)). |

While we welcome the proposed modification (which will facilitate the analysis on portfolio composed of loans and related financial guarantee), we strongly recommend the Board to clarify that the correct View of its proposal is View A as described above. This should be clearly stated in the standard, for example through an amendment of the proposed wording in paragraph AG42A.

**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?

Yes we agree, but we consider that additional guidance is needed.

The exposure draft proposes a definition of the transfer as an agreement to pass “*some or all of the economic benefits underlying one or more of its assets*”. We recommend the Board to clarify the definition of “economic benefits”. For example, it is unclear whether the voting right of an equity instrument qualifies as an “economic benefit” according to the exposure draft.

Furthermore, we consider that the Board should provide additional guidance on the required conditions to qualify an agreement to pass the cash flows of an asset as a “transfer” according to the exposure draft.

The exposure draft provides two examples of equity linked note issue in paragraph AG52L(f) and AG52L(g). We do not understand whether the conditions mentioned in paragraph AG52L(g) are mandatory to qualify the transaction as a transfer.

The conditions mentioned in paragraph AG52L(g) are very similar to those of the current *Pass through arrangement* except the “without material delay” criteria. We would appreciate more guidance on the difference between:
- the conditions required to qualify a transaction as a transfer under the proposed approach and,
- the conditions of the current *pass through arrangement* as described in paragraph 19 of IAS 39

This issue is key as entities such as monetary funds could be seen as “empty shells” if it were considered that a transfer exists between their assets and liability. The issue is critical too for insurers on their unit-linked contracts.

**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?

No, we do not agree. Even if we welcome the Board’s simplification objective resulting in a much simpler approach, we consider that the proposal embeds major flaws leading to counterintuitive outcome.

We understand that the proposed “continuing involvement” is different from the current “continuing involvement” concept defined in paragraph 30 of IAS 39. We recommend the Board to find another wording than “continuing involvement” for the new proposed approach in order to avoid any misunderstanding.

We agree that an asset should be derecognised each time that the transferor has no more continuing involvement in the transferred asset. But we consider that a transferor should not be able to derecoginse an asset if it retains all of its risks and rewards. We do not understand why the proposed approach is not symmetrical.

This is the case for instance for Repurchased agreement (Repo). In this transaction an entity sells an asset with the firm commitment to reacquire it on a fixed date at a fixed price. The transferor retains all the risks and rewards of the asset. As the transferred asset is usually quoted in an active market, the proposed approach would lead the transferor to derecognise it.

In this case we believe that the proposed approach is flawed by permitting the derecognition of an asset when the transferor retains all its risks and rewards.

The exposure draft states at paragraph 17A (b) “*the entity transfers the Asset and has no continuing involvement in it*”. We regret that the Board did not introduce some kind of materiality trigger in its wording as it did in the current IAS 39 (which states at paragraph 20(a) “*substantially all risks and rewards*”). The proposed wording could result in transfers not qualified for derecognition only because the transferor has retained an insignificant continuing involvement, which we believe does not reflect the economic reality of the transaction.
Let us take the following example: an entity transfers a portfolio of commercial receivables retaining 5% of the transferred asset credit risk. We consider that the Board should clarify that in this case:
- the 5% of credit risk retained is not significant,
- should not trigger the existence of a continuing involvement
- and should therefore not preclude the derecognition of the transferred asset.

We believe that the simplest way to address our two concerns mentioned above is to reintroduce the current risks and rewards filter as defined in IAS 39 paragraph 20(a) and 20(b).

Despite the above criticism, we would like to underline several areas in which the proposed approach brings improvements compared to the current IAS 39.

We welcome the fact that partial derecognition is not a possible outcome under the proposed approach. We consider that the current recognition “to the extent of the entity’s continuing involvement” as described in paragraph 30 to 35 of IAS 39 is not transparent, too complex to understand, and therefore useless for the financial statements user.

We welcome the exposure draft proposal to deal explicitly with “normal representation and warranties” in paragraph 18A(a). We think however that further guidance is needed to define more precisely the scope of this exemption. We would advise the Board to take a clear position on dilution risk\(^1\) especially in the context of a commercial receivables securitisation. We consider that dilution risk should be considered as a “normal representation and warranty”.

We wonder whether the retention of an equity security voting right is by itself sufficient to consider that a transferor has retained a continuing involvement in this security.

**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?*

No we do not agree. As already mentioned, we consider that the proposed approach mainly based on the ‘control’ criteria provides outcomes which are counterintuitive and do not reflect the economic reality of the transaction.

Example AG52L(a) and AG52L(g) lead both to derecognition although in the first one the entity transfers no or very few risks and rewards, and in the latest the entity transfers substantially all risks and rewards. We consider that these situations are economically very different and should therefore not lead to the same accounting treatment.

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\(^1\) Dilution risk can be defined as the risk that reality of the transferred receivables could be put into question due to the performance of the transferor (claim from the transferor’s client due to insufficient performance of the transferor, rebate accorded by the transferor to its client within a global commercial relationship etc)
The exposure draft seems to focus on the control of the economic benefits realised through a sale as there is a focus on the “transferee’s ability to transfer the asset” (paragraph 17A). But controlling the economic benefits that would arise if an asset is sold is not the same as controlling the economic benefits inherent in an asset. For example, if an entity buys a distressed receivable with a discount and holds it until maturity, the entity can realise a significant profit thanks to a recovery higher than initially expected. The fact that the holder has the practical ability to transfer this asset has no influence on its capacity to retain these economic benefits.

In order to avoid this kind of situation, we advise the Board to reintroduce the current risks and rewards filter as defined in IAS 39 paragraph 20(a) and 20(b).

Moreover, we consider that a control analysis performed from the transferee point of view raises major practical issues. The transferor is generally able to identify the transferee constraints related to the transfer’s contractual requirements. However, the transferor may not be aware of transferee’s other practical constraints (e.g. for regulatory, tax or local purposes such as Islamic finance). This kind of analysis seems difficult to perform and could therefore provide structuring opportunities.

We consider that, from the transferor point of view, similar transactions should lead to similar accounting treatment. Under the proposed approach it would not be the case in the following example:

- The transferor could choose the transferee on the basis of its ability to sell the asset. Thus, the same transaction could result in a different accounting treatment only because the selected transferee has, or has not, the practical ability to transfer the asset given its specific environment (tax, regulatory etc).
- A transaction with the same transferee could be accounted for differently by a large firm which is able to pay for a study demonstrating that the transferee has specific constraints due to its environment, or a SME which may have no idea of the transferee’s practical ability.

That is why we strongly recommend to the Board to clarify in paragraph AG52E, that the “practical ability to transfer” has to be assessed only on the basis of contractual constraints and the transferred asset characteristic which are well known by the transferor, and not the specific environment of the transferee.

**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?**

No, we do not agree.

As mentioned in our cover letter, we acknowledge that the proposed approach is similar to the current IAS 39 rule mentioned in paragraph 20(c)(i) and 23. But very little practice has been developed on this control test as the current approach is mainly focused on a risks and rewards analysis. We therefore disagree with the implementation of the proposed approach without prior in depth field testing.
The proposed approach considers that the transferor has lost the control of the transferred asset if and only if, the transferee has the practical ability to dispose of the asset for its own benefit. We consider that a transferor could lose the control of a transferred asset without the transferee having the practical ability to sell the asset.

We disagree with the paragraph AG52F. We are not in favour of a continuous reassessment of the “practical ability to transfer”. We consider that the analysis should be performed on the date of the transfer without further reassessment. The proposed approach could lead an entity to derecognise a previously transferred asset several months after its transfer, just because the liquidity of the transferred asset’s market increases. For instance a 3-year bond could not qualify for derecognition in the absence of a market, while, one year after, the same would qualify for derecognition if the 3-year bonds market is liquid. We do not consider that the way market activity fluctuates should impact the recognition of an entity asset. It seems to us that it is more a matter of measurement than a matter of recognition.

Should the Board decide to maintain the proposed approach, we would appreciate clarification on the issues detailed below.

The way the control analysis shall be performed is not consistently described through the exposure draft. In paragraph 17A(c), the exposure draft requires an analysis performed from the transferee point of view: “[…] the transferee has the practical ability to transfer the Asset […]”. But in the application guidance, in paragraph AG52L(g), the exposure draft performs an analysis from the transferor point of view: “[the transferor] is prohibited from transferring the shares […]”. Should the Board choose to retain the proposed approach, we would recommend clarifying this point.

We would appreciate more guidance on transfer of a large number of similar assets quoted in an active market. We question whether the control analysis would be the same for the transfer of one quoted equity security than for a large number of this security, especially when the transferred portfolio exceeds the volume exchanged on the market in one or several weeks.

We consider that the Board should clarify that the exceptions mentioned in paragraph 18A are not only valid for the transfer analysis but also for the control analysis.

**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?

Yes we agree.
However, we recommend the Board to provide more guidance on this issue. It seems to us that, in the case of an interest retained indirectly through an entity, the transferor may lack information on the entity assets and liability to perform the split required by paragraph 22A.

We also have a concern relative to the existence of an embedded derivative when a transfer applies only to a part of an asset. The transferor could have to recognise a retained interest which could be analysed as a host contract plus an embedded derivative. We believe that the Board should consider amending IFRIC 9 to clarify that a new embedded derivative analysis should be performed.

**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?**

No, we do not agree that the proposed approach as a whole should be established as the new approach for determining the derecognition of financial assets.

As explained in our cover letter, we welcome several major improvements towards simplification such as the end of partial derecognition (current continuing involvement approach). But we believe that the proposed approach embeds significant flaws leading to counterintuitive outcome and major practical implementation issues (please refer to our answers to questions 4 and 5).

We do not support either the approach described in the alternative view. Even if it may appear at first sight simpler, the use of fair value to recognise the new asset and/or obligation would raise a lot of implementation issues (especially measurement) as the portion transferred could be defined in a very complex way. Moreover, we have a major concern on the possibility to recognise a Profit or Loss impact on an asset in its entirety whereas only a very small portion is being transferred. Should the Board continue on the way proposed by the alternative approach, as it is very innovative, it should be submitted to a dedicated due process (including field testing and detailed exposure draft).

We agree that the current IAS 39 approach on derecognition is not fully consistent and that improvement and simplification is needed in several areas. However, we consider that the current approach is now well understood and consistently applied. Moreover, it has not shown any major flaw in the recent context of financial crisis. Given the timing constraint of the Board, we therefore favour few amendments to the current approach rather than the adoption of a brand new approach developed without having performed extensive field testing.

On this basis our recommendation is to adopt a two step process:
Step 1: in the short term, in order to simplify the current IAS 39 derecognition approach, the Board should consider the following amendments to:

- abandon any partial derecognition outcome (current continuing involvement approach)
- deal explicitly with « normal representation and warranties » as proposed in paragraph 18A(a) of the exposure draft (please refer to our answer to question 4).
- add disclosure where necessary on the basis of the recent financial crisis experience

Step 2: In the mid term, develop a new derecognition approach taking into consideration the transfer of substantially all risks and rewards. This approach should be confirmed by extensive field testing.

Should however the Board elect to adopt the approach detailed in the exposure draft, we would recommend proceeding to the following modifications to:

- reintroduce the current risks and rewards filter as defined in IAS 39 paragraph 20(a) and 20(b).
- improve consistency of the control definition within the approach and clarify that the control analysis should be performed from the transferor point of view, not from the transferee’s
- specify that the analysis should be performed on the transfer date without further reassessment (except in the case of a contractual modification).
- provide detailed guidance on what qualify as a transfer, especially when the cash flow transfer is performed through the issue of a liability.

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?

Regarding the definition of control within the exposure draft on derecognition, we noted that this concept is different from the one used in the exposure draft “consolidation” (definition of the control based on an “ability to sell” from the transferee point of view vs. “power to direct the activities of that other entity to generate returns for the reporting entity”).
If we agree that the control of an asset should not be defined in the same way as the control of an entity, we consider that both definitions should rely on the same core principle. Accordingly, we believe that both definition of control should be developed from the entity’s point of view (i.e. regarding derecognition from the transferor) for the reasons developed in question 5.

**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?**

Yes we agree. We believe that the proposed wording will not result in any significant change compared to the current approach.

In paragraph 42B the exposure draft states that when an entity derecognises a financial liability as a result of an exchange of debt instruments, it includes any costs or fees incurred in the gain or loss recognised. We understand through this accounting treatment that all fees incurred in this exchange are affected to the derecognised debt instrument. Consequently, the new debt instrument is recognised without any transaction cost. We acknowledge that this wording is in line with the current IAS 39 paragraph AG62. However we consider that including any fees specifically allocated to the new debt issue in its initial amortised cost would be:

- more consistent with other transaction costs treatment (paragraph 9 and 43 of IAS 39),
- in line with the US Gaap treatment on costs incurred with third parties (EITF 96-19).

We would appreciate clarification of the Board position on this issue.

**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?**

Although we consider that retrospective application is generally the best way to grant comparability to the financial statement users, we agree with the Board that prospective application is the best way to proceed on this complex issue.

We would recommend the Board to clarify, for revolving transactions, that a prospective application is required from the date of the first revolving after the date specified in paragraph 106.
Let us take the following example. An entity enters into a five year master agreement with a bank to sell each month a portfolio of commercial receivables. We consider that the amendment to IAS 39 on derecognition should be applied prospectively on any transfer of commercial receivable portfolio occurring after the date specified in paragraph 106 even though the master agreement has been concluded before that date.

**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?**

As a general principle, we agree that additional disclosure can be needed in order to help users of financial statements to better understand the statement of financial position and statement of comprehensive income. However, we do not support an approach which leads to a transfer of information from the statement of financial position (through an increased number of transactions leading to derecognition) to the disclosure (through additional detailed requirement).

Therefore we consider that the proposed additional disclosure can not by itself compensate the major flaws identified in our answer to question 4 and 5.

Regarding the exposure draft proposal, we consider that redundancy may appear within IFRS 7 between existing requirements and the new requirements added by the exposure draft (e.g. maximum exposure to loss from its continuing involvement (ED par. 42D(c) and sensitivity analysis)).

**Other Issues**

It is explained in paragraph BC4 that one of the exposure draft’s core principles is to derecognise any item which fails to qualify as an asset of the entity according to the Framework. Currently the framework defines an ‘asset’ as a “resource controlled by an entity as a result of past events and from which future economic benefits are expected to flow to the entity”.

The Board, in its joint project with the FASB on the Framework, tentatively adopted the following working definition of an asset: “An asset of an entity is a present economic resource to which the entity has a right or other access that others do not have”.

We question whether the approach proposed in the exposure draft will be consistent with the future definition of an asset in the Framework. We believe that the Board should deal with this issue in its basis for conclusion.