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Accounting for Securitisation Transactions Under the New Revised IAS 39: Good News or Bad News

By Marty Rosenblatt and Jim Mountain

Just before Christmas 2003, the International Accounting Standards Board (IASB) issued the revised International Accounting Standard 39 *Financial Instruments:Recognition and Measurement* (IAS 39). IAS 39 is to be applied for annual periods beginning on or after January 1, 2005[1]. Earlier application is permitted. This SOS deals only with the derecognition provisions of IAS 39 and does not address the various other topics addressed in the 200-page IAS 39 document including recognition, measurement, derivatives and hedging.

This SOS summarizes the IAS 39 guidance relating to accounting for securitisations in what we hope is a logical and meaningful order. The Standard is quite complex and the IASB cautions in the Basis For Conclusions [BC 63][2] that many securitisations may fail to qualify for derecognition either because the entity has retained substantially all the risks and rewards of ownership or has failed to meet certain prescribed conditions.

An entity that has securitised financial assets first consolidates all subsidiaries in accordance with IAS 27 and SIC-12 *Consolidation-Special Purpose Entities*[3] and then applies the IAS 39 guidance to the resulting group at a consolidated level. [15] Whether a transfer of a financial asset qualifies for derecognition does not differ depending on whether the transfer is direct to investors or through a consolidated SPE or trust that obtains the financial assets and, in turn, transfers a portion of those financial assets to third party investors.[BC64]

There is no concept analogous to the Qualifying Special-Purpose Entity in FAS 140, which is automatically exempt from consolidation. On the other hand, there is no FAS 140-type legal isolation requirement that the transferred assets have to be put beyond the reach of the transferor and their creditors even in the event of bankruptcy or receivership. *(See page 8 for a comparison of IAS 39 and FAS 140/FIN 46R.)*

When an entity[4] ***transfers*** *(see next paragraph)* a financial asset (or a part of[5], or a group of similar, financial assets), it shall evaluate the extent to which it retains the risks and rewards of ownership of the financial asset.

IF:

(1) The entity ***transfers*** substantially all the risks and rewards of ownership of the financial asset…

then

The entity derecognises the financial asset and recognises separately as assets or liabilities any rights and obligations created or retained in the transfer.

IF:

(2) The entity ***retains*** substantially all the risks and rewards of ownership of the financial asset (i.e. the entity continues to absorb all of the likely variability in net cash flows)…

then

The entity shall continue to recognise the financial asset and an associated liability for the proceeds.[6] [20]

IF:

(3) The entity neither transfers nor retains substantially all the risks and rewards of ownership (e.g. it transfers a significant amount but not substantially all of the risks and rewards)…

then

The accounting is much more complex and is described later in this article under the heading Accounting for Continuing Involvement…

An entity is considered to have ***transferred*** a financial asset if, and only if, it either:

(1) transfers the contractual rights to receive the cash flows of the financial asset; or

(2) retains the contractual rights to receive the cash flows of the financial asset (the "original asset"), (for example, it retains servicing of the assets), but assumes a contractual obligation to pass-through those cash flows to one or more entities (the "eventual recipients") and all of the following conditions are met: [18]

(a) The entity has no obligation to pay amounts to the eventual recipients unless it collects equivalent amounts from the original asset. Short-term advances by the entity with the right of full recovery of the amount lent plus accrued interest at market rates do not violate this condition.

(b) The entity is prohibited by the terms of the transfer contract from selling or pledging the original asset other than as security to the eventual recipients for the obligation to pay them cash flows.

(c) The entity has an obligation to remit any cash flows it collects on behalf of the eventual recipients without material delay. In addition, the entity is not entitled to reinvest such cash flows, except for investments in cash or cash equivalents during the short settlement period from the collection date to the date of required remittance to the eventual recipients, and interest earned on such investments is passed to the eventual recipients.[19]

If the arrangement fails to meet any of the conditions above, the entity continues to recognize the asset in its entirety and records any proceeds received as a liability.

Provision (c) above will likely have the effect of causing all revolving structures to fail to qualify for derecognition. Although it has been argued that revolving structures effectively represent the investors' purchasing new assets with the proceeds of those that have been collected, the new assets would not be investments in cash or cash equivalents. Also, transactions in which the transferor receives the float from temporary investments will not qualify for derecognition. It is unclear, if the transferor were not the servicer and did not retain the contractual right to receive the cashflows from the financial asset, whether a revolving structure where interim collections are to be used to acquire new assets and/or the servicer is entitled to keep reinvestment earnings on collections awaiting distribution to investors, might be viewed as an eligible transfer.

The objective of prescribing these conditions to qualify as a transfer to be considered for derecognition is to distinguish pass-through arrangements in which the entity acts more as an agent of the eventual recipients of the cash flows than as an owner of the asset having both an asset and a liability. [BC56] Condition (a) indicates that a transferor has no liability (because there is no present obligation to pay cash), and conditions (b) and (c) indicate that the transferor has no asset (because the transferor does not control the future economic benefits associated with the transferred asset). [BC 60]

The transfer of risks and rewards is evaluated by comparing the entity's exposure, before and after the transfer, with the variability in the amounts and timing of the net cash flows of the transferred asset. An entity has retained substantially all the risks and rewards of ownership of a financial asset if its exposure to the variability in the present value of the future net cash flows from the financial asset does not change significantly as a result of the transfer. An entity has transferred substantially all the risks and rewards of ownership of a financial asset if its exposure to such variability is no longer significant in relation to the total variability in the present value of the future net cash flows associated with the financial asset. [21]

Examples of an entity transferring substantially all the risks and rewards of ownership are:

(1) an unconditional sale of a financial asset;

(2) a sale of a financial asset together with an option to repurchase the financial asset at its fair value at the time of repurchase; and

(3) a sale of a financial asset together with a put or call option that is deeply out of the money (i.e. an option that is so far out of the money it is highly unlikely to go into the money before expiring). [AG39]

Examples of an entity retaining substantially all the risks and rewards of ownership are:

(1) a sale and repurchase transaction where the repurchase price is a fixed price or the sale price plus a lender's return;

(2) a securities lending agreement;

(3) a sale of a financial asset together with a total return swap that transfers the market risk exposure back to the entity;

(4) a sale of a financial asset together with a deep in-the-money put or call option (i.e. an option that is so far in the money that it is highly unlikely to go out of the money before expiring); and

(5) a sale of short-term receivables in which the entity guarantees to compensate the transferee for credit losses that are likely to occur. [AG 40]

Often it will be obvious whether the entity has transferred substantially all risks and rewards of ownership or retained substantially all risks and rewards and there will be no need to perform any computations. In other cases, it will be necessary to compute and compare the entity's exposure to the variability in the present value of the future net cash flows before and after the transfer. The computation and comparison is made using as the discount rate an appropriate current market interest rate. All reasonably possible variability in net cash flows is considered, with greater weight being given to those outcomes that are more likely to occur.[22] This guidance is reminiscent of the principles in FIN 46R, but the IASB did not specify what statistic (e.g.. standard deviation, variance or mean absolute deviation as in FIN 46R) should be used to measure "variability." Nor did they give bright-line guidance on the cut-off levels for "substantially all."

Sometimes, the entity will have been deemed to have transferred the assets but neither transferred substantially all of the risks and rewards of ownership of the assets nor retained substantially all of the risks and rewards. Then it is necessary to determine if the entity has retained control of the asset to arrive at the appropriate accounting. Whether the entity has retained control of the transferred asset depends on the transferee's ability to sell the asset. If the transferee has the practical ability to sell the asset in its entirety to an unrelated third party and is able to exercise that ability unilaterally and without needing to impose additional restrictions on the transfer, the entity has not retained control. In all other cases, the entity has retained control.

If the entity has not retained control of the asset, it shall derecognise the asset and recognise separately as assets or liabilities any rights and obligations created or retained in the transfer. If the entity has retained control (expected to be the usual case in securitisations), it shall continue to recognise the financial asset *to the extent of its continuing involvement* in the financial asset (see below). [20(c)] This is to reflect the transferor's continuing exposure to the risks and rewards of the asset. This exposure is not related to the entire asset, but is limited in amount. The IASB noted that precluding derecognition to the extent of the continuing involvement is useful to users of financial statements in such cases, because it reflects the entity's retained exposure to the risks and rewards of the financial asset better than full derecognition (as would be the case under FAS 140). [BC 67]

The following table highlights the possible scenarios and the associated accounting result that would be applied under the new, IAS 39 (as revised). An entity that has securitised financial assets first consolidates all subsidiaries in accordance with IAS 27 and SIC-12, *Consolidation-Special Purpose Entities* and then applies the IAS 39 guidance to the resulting group at a consolidated level. The entity also has to determine whether the evaluation of the transfer of risks and rewards is to be performed for all of an asset or a part of an asset, in accordance with paragraph 16 (see endnote 5).

Case	Primary Condition	Secondary Condition	Accounting Result
1.	The entity has transferred its rights to receive the cash flows from the asset OR The entity has assumed an obligation to pass-through the cash flows from the asset (eg as a servicer) and meets the conditions of ¶19*	The entity has transferred substantially all risks and rewards	Derecognise the asset and record any new asset obtained and any new liability assumed and profit or loss
2.	The entity has transferred its rights to receive the cash flows from the asset OR The entity has assumed an obligation to pass-through the cash flows from the asset (eg as a servicer) and meets the conditions of ¶19*	The entity has retained substantially all risks and rewards (e.g. with a total return swap)	Continue to recognise the asset and record any proceeds as a liability
3.	The entity has transferred its rights to receive the cash flows from the asset OR The entity has assumed an obligation to pass-through the cash flows from the asset (eg as a servicer) and meets the conditions of ¶19*	The entity has transferred some but not substantially all risks and rewards AND Has not retained control of the asset**	Derecognise the asset and recognise any new financial asset, financial liability or servicing liability at fair value and profit and loss
4.	The entity has transferred its rights to receive the cash flows from the asset OR The entity has assumed an obligation to pass-through the cash flows from the asset (eg as a servicer) and meets the conditions of ¶19*	The entity has transferred some but not substantially all risks and rewards AND Has retained control of the asset**	Continue to recognise the asset to the extent of the entity's continuing involvement and an associated liability
5.	The entity has assumed an obligation to pass-through the cash flows from the asset (eg as a servicer) but does not meet the conditions of ¶19*	Not applicable**	Continue to recognise the asset and record any proceeds as a liability

* The conditions for a "pass-through" transfer in paragraph 19 are summarized as follows (also see discussion on page 2):

(a) The entity has no obligation to pay amounts to the eventual recipients unless it collects equivalent amounts from the original asset.

(b) The entity is prohibited by the terms of the transfer contract from selling or pledging the original asset other than as security to the eventual recipients for the obligation to pay them cash flows.

(c) The entity has an obligation to remit any cash flows it collects on behalf of the eventual recipients without material delay.

** Whether the entity has retained control of the transferred asset depends on the transferee's ability to sell the asset. If the transferee has the practical ability to sell the asset in its entirety to an unrelated third party and is able to exercise that ability unilaterally and without needing to impose additional restrictions on the transfer, the entity has not retained control. In all other cases, (typical in securitisations) the entity has retained control.

Accounting for Transfers that Qualify for Derecognition

If, as a result of a transfer, a financial asset is derecognised in its entirety but the transfer results in the entity obtaining a new financial asset or assuming a new financial liability, or a servicing liability, the entity shall recognise the new financial asset, financial liability or servicing liability at fair value in recognising gain or loss. [25]

Recording a Servicing Asset or Liability

If an entity transfers a financial asset in a transfer that qualifies for derecognition in its entirety and retains the right to service the financial asset for a fee, it shall recognise either a servicing asset or a servicing liability for that servicing contract. If the fee to be received is not expected to compensate the entity adequately for performing the servicing, a servicing liability for the servicing obligation shall be recognised at its fair value. If the fee to be received is expected to be more than adequate compensation for the servicing, a servicing asset shall be recognised for the servicing right at an amount determined on the basis of an allocation of the carrying amount of the larger financial asset. [24]

Interest-Only Strips vs. Excess Servicing Assets

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 upon 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. 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 there is no servicing fee specified or the fee to be received is not expected to compensate the entity adequately for performing the servicing, a liability for the servicing obligation is recognised at fair value. [AG45]

Calculation of Gain or Loss

On derecognition of a financial asset in its entirety, the difference between:

(1) the carrying amount and

(2) the sum of (i) the consideration received (including any new asset obtained less any new liability assumed) and (ii) any cumulative gain or loss that had been recognised directly in equity shall be recognised in profit or loss.[26]

If the transferred asset is part of a larger financial asset (e.g. when an entity transfers interest cash flows that are part of a debt instrument, and the part transferred qualifies for derecognition in its entirety), the previous carrying amount of the larger financial asset shall be allocated between the part that continues to be recognised and the part that is derecognised, based on the relative fair values of those parts on the date of the transfer. For this purpose, a retained servicing asset shall be treated as a part that continues to be recognised. The difference between:

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

(2) the sum of (i) the consideration received for the part derecognised (including any new asset obtained less any new liability assumed) and (ii) any cumulative gain or loss allocated to it that had been recognised directly in equity shall be recognised in profit or loss. A cumulative gain or loss that had been recognised in equity is allocated between the part that continues to be recognised and the part that is derecognised, based on the relative fair values of those parts.

Determining Fair Value

When an entity allocates the previous carrying amount of a larger financial asset between the part that continues to be recognised and the part that is derecognised, the fair value of the part that continues to be recognised needs to be determined. When the entity has a history of selling parts similar to the part that continues to be recognised or other market transactions exist for such parts, recent prices of actual transactions provide the best estimate of its fair value. IAS 39 discourages the recognition of the positive arbitrage that might result from a securitisation execution vs. a whole loan sale, whenever there are illiquid securities or other non-traded instruments retained by the transferor. When there are no price quotes or recent market transactions to support the fair value of the part that continues to be recognised, IAS 39 says that the best estimate of the fair value is the difference between the fair value of the larger financial asset as a whole and the consideration received from the transferee for the part that is derecognised. [28]

Accounting for Transfers that Do Not Qualify for Derecognition

If a transfer does not result in derecognition because the entity has retained substantially all the risks and rewards of ownership of the transferred asset, the entity shall continue to recognise the transferred asset in its entirety and shall recognise a financial liability for the consideration received. In subsequent periods, the entity shall recognise any income on the transferred asset and any expense incurred on the financial liability. [29]

If a transferred asset continues to be recognised, the asset and the associated liability may not be offset. Similarly, the entity shall not offset any income arising from the transferred asset with any expense incurred on the associated liability. [36]

If the transferred asset is measured at amortised cost, the option in IAS 39 to designate a financial liability at fair value through profit or loss is not applicable to the associated liability.[35]

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 transfer are not accounted for separately as derivatives if recognising both the derivative 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.[AG49]

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. If the transferor has both a right and an obligation to reacquire control of the entire transferred asset for a fixed amount (such as under a repurchase agreement), the transferee may account for its receivable as a loan or receivable. [AG50]

Accounting for Continuing Involvement in Transferred Assets When the Entity Has Retained Control of the Asset (i.e. the Transferee Can Not Sell the Asset) and Some But Not Substantially all of the Risks are Transferred

One aspect of IAS 39 that we find quite confusing (and is sure to remain quite controversial) is the accounting for retained subordinated interests. The retained subordinated interests stay on balance sheet, as would be expected, provided that some but not substantially all of the risk and rewards has been transferred. However, since the subordination effectively provides a credit guarantee for a portion of the interest sold to investors, that is considered a form of continuing involvement. This means that a portion of the investors' interest (i.e. the senior interest) does not qualify for derecognition. Instead, an additional amount equal to the subordinated retained interest stays on balance sheet as loans and an associated amount received as sales proceeds [plus the fair value of the credit enhancement] is recorded as a borrowing. This has been described by many as "double-counting" because the total of the two assets in the balance sheet (without regard to the associated liability recognized) is twice the maximum loss that the transferor could suffer under even the most extreme cases.

If an entity transfers some but not substantially all the risks and rewards of ownership of a transferred asset, and retains control of the transferred asset, the entity continues to recognise the transferred asset to the extent of its continuing involvement. The extent of the entity's continuing involvement in the transferred asset is the extent to which it is exposed to changes in the value of the transferred asset. For example:

(1) when the entity's continuing involvement takes the form of guaranteeing the transferred asset, the extent of the entity's continuing involvement is the lower of (i) the amount of the asset and (ii) the maximum amount of the consideration received that the entity could be required to repay ('the guarantee amount').

(2) when the entity's continuing involvement takes the form of a written or purchased option (or both) on the transferred asset, the extent of the entity's continuing involvement is the amount of the transferred asset that the entity may repurchase. However, in case of a written put option on an asset that is measured at fair value, the extent of the entity's continuing involvement is limited to the lower of the fair value of the transferred asset and the option exercise price. These provisions apply to both cash-settled and physically settled arrangements. [30]

When an entity continues to recognise an asset to the extent of its continuing involvement, the entity also recognises an associated liability. Despite the other measurement requirements in IAS 39, the transferred asset and the associated liability are measured on a basis that reflects the rights and obligations that the entity has retained. The associated liability is measured in such a way that the net carrying amount of the transferred asset and the associated liability is:

(1) the amortised cost of the rights and obligations retained by the entity, if the transferred asset is measured at amortised cost;

or

(2) equal to the fair value of the rights and obligations retained by the entity when measured on a stand-alone basis if the transferred asset is measured at fair value. [31] This approach is intended to result in the asset and the associated liability being measured in a way that ensures that any changes in value of the transferred asset that are not attributed to the entity are not recognized by the entity. [BC 68]

If a guarantee provided by an entity to pay for default losses on a transferred asset prevents the transferred asset from being derecognised to the extent of the continuing involvement, the transferred asset at the date of the transfer is measured at the lower of (i) the carrying amount of the asset and (ii) the maximum amount of the consideration received in the transfer that the entity could be required to repay ('the guarantee amount'). The associated liability is initially measured at the guarantee amount plus the fair value of the guarantee

(which is normally the consideration received for the guarantee). Subsequently, the initial fair value of the guarantee is recognised in profit or loss on a time proportion basis and the carrying value of the asset is reduced by any impairment losses. [AG48(a)]

The entity shall continue to recognise any income arising on the transferred asset to the extent of its continuing involvement and shall recognise any expense incurred on the associated liability. [32]

If an entity's continuing involvement is in only a part of a financial asset (e.g. when an entity retains an option to repurchase part of a transferred asset, or retains a residual interest that does not result in the retention of substantially all the risks and rewards of ownership and the entity retains control), the entity allocates the previous carrying amount of the financial asset between the part it continues to recognise under continuing involvement, and the part it no longer recognises on the basis of the relative fair values of those parts on the date of the transfer. For this purpose, the requirements of paragraph 28 apply. The difference between:

(1) the carrying amount allocated to the part that is no longer recognised; and

(2) the sum of (i) the consideration received for the part no longer recognised and (ii) any cumulative gain or loss allocated to it that had been recognised directly in equity shall be recognised in profit or loss.

A cumulative gain or loss that had been recognised in equity is allocated between the part that continues to be recognised and the part that is no longer recognised on the basis of the relative fair values of those parts. [34]

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 transfer are not accounted for separately as derivatives if recognising both the derivative 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.[AG49]

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. If the transferor has both a right and an obligation to reacquire control of the entire transferred asset for a fixed amount (such as under a repurchase agreement), the transferee may account for its receivable as a loan or receivable. [AG50]

Some Common Forms of Continuing Involvement

Clean-up calls. An entity, which may be a transferor, that services transferred assets may hold a clean-up call to purchase remaining transferred assets when the amount of outstanding assets falls to a specified level at which the cost of servicing those assets becomes burdensome in relation to the benefits of servicing. Provided that such a clean-up call results in the entity neither retaining nor transferring substantially all the risks and rewards of ownership and the transferee cannot sell the assets, it precludes derecognition only to the extent of the amount of the assets that is subject to the call option.[AG51(m)]

Amortising interest rate swaps. An entity may transfer to a transferee a fixed rate financial asset that is paid off over time, and enter into an amortising interest rate swap with the transferee to receive a fixed interest rate and pay a variable interest rate based on a notional amount. If the notional amount of the swap amortises so that it equals the principal amount of the transferred financial asset outstanding at any point in time, the swap would generally result in the entity retaining substantial prepayment risk, in which case the entity either continues to recognise all of the transferred asset or continues to recognise the transferred asset to the extent of its continuing involvement. Conversely, if the amortisation of the notional amount of the swap is not linked to the principal amount outstanding of the transferred asset, such a swap would not result in the entity retaining prepayment risk on the asset. Hence, it would not preclude derecognition of the transferred asset provided the payments on the swap are not conditional on interest payments being made on the transferred asset, and the swap does not result in the entity retaining any other significant risks and rewards of ownership on the transferred asset. [AG51(q)]

Subordinated retained interests and credit guarantees. An entity may provide the transferee with credit enhancement by subordinating some or all of its interest retained in the transferred asset. Alternatively, an entity may provide the transferee with credit enhancement in the form of a credit guarantee that could be unlimited or limited to a specified amount. If the entity retains substantially all the risks and rewards of ownership of the transferred asset, the asset continues to be recognised in its entirety. If the entity retains some, but not substantially all, of the risks and rewards of ownership and has retained control, derecognition is precluded to the extent of the amount of cash or other assets that the entity could be required to pay.[AG51(n)]

COMPARISON of IASB IAS 39 and FASB 140/FIN 46R

	IAS 39	FASB 140/FIN 46R
Spelling	Securitisation	Securitization
Legal isolation of assets	Not required	Required
Transferee/Investors ability to pledge or exchange	Not required*	Required
Call options	Borrowing to the extent of the option**	Borrowing to the extent of the option, for most types
Cleanup calls	Borrowing to the extent of the option**	Does not preclude 100% sale
Transferee put options	Borrowing to the extent of the option**	Still a sale provided true sale opinion is obtained
Consolidation of SPEs	Usually, under SIC 12 ,but derecognition is evaluated on a consolidated basis.	Not if it is a QSPE; For non-QSPE VIEs, consolidated with a primary beneficiary, if any, with majority loss/ residual return exposure
Ability to guarantee	Borrowing to the extent of the guarantee**	Still a sale provided true sale opinion is obtained
Ability to retain subordinated interest	Borrowing to the extent of the subordinated amount**	Senior interests still eligible for sale accounting
Ability to enter into a total return swap	Borrowing	May be a sale if legal isolation can be achieved
Cap on gain based on whole loan proceeds	Yes	No
Ability to repurchase any individual loan	Borrowing to the extent of repurchase option limit**	100% borrowing
Revolving structures	No derecognition if transferor retains contractual right to receive the cash flows on the underlying asset (e.g. servicing)	OK

* Unless some but not substantially all of the risks and rewards are transferred. Then to derecognise, the entity must not retain control as evidenced by the transferee having the ability to sell the assets.

** Assuming some but not substantially all of the risks and rewards are transferred and control has been retained (i.e. the transferee can not sell the asset).

All information contained in this article is general in nature and does not serve as a substitute for consultation with a professional or a careful reading of FIN 46 and FIN 46R.

[1] A first-time adopter in 2005 may apply the derecognition requirements in IAS 39 retrospectively for financial years beginning on or after January 1, 2004. In other words, an entity does not recognise assets transferred in a securitisation in financial years beginning before January 1, 2004 if those transactions qualified for derecognition under previous GAAP. However, any further transfers of financial assets to the same securitisation or other transaction in financial years beginning on or after January 1, 2004 qualify for derecognition only if they meet the derecognition criteria of IAS 39. Alternatively, an entity may apply the derecognition requirements in IAS 39 retrospectively from an earlier date of the entity's choosing. [IG53]

[2] Numbers in brackets refer to paragraph numbers in IAS 39.

[3] Under SIC 12, an enterprise should consolidate a special purpose entity ("SPE") when, in substance, the enterprise controls the SPE. SIC 12 provides examples of when control may exist in the context of an SPE. The examples include a securitisation of financial assets where the reporting enterprise has rights to the majority of benefits and exposure to significant risks of the SPE.

[4] The entity could be, for example, the originator of the financial asset, or it could be a group that includes a consolidated special purpose entity that has acquired the financial asset and passes on cash flows to unrelated third party investors. [AG38].

[5] A part of a financial asset is considered separately for derecognition only if the transferor retains:(a) only specifically identified cash flows from a financial asset (or a group of similar financial assets) (b) only a fully proportionate (pro rata) share of the cash flows from a financial asset (or a group of similar financial assets); or (c) only a fully proportionate (pro rata) share of specifically identified cash flows from a financial asset (or a group of similar financial assets). [16] For example, if an entity transferred to a securitisation trust all the principal and all but 1% of the interest flows from a pool of financial assets, and the interest strip was not subordinated in any way, the remaining interest and all of the principal would be the financial asset for which the transfer of risks and rewards would be evaluated. On the other hand, if the 1% interest strip was subordinated for purposes of providing credit enhancement to the investors' principal, then the entire asset (e.g. pool of loans) would be the financial asset for which the transfer of risks and rewards would be evaluated. These conclusions would be unaffected by whether the trust issued to outside investors varying classes of beneficial interests.

[6] If a transferred asset continues to be recognised, the asset and the associated liability shall not be offset. Similarly, the entity shall not offset any income arising from the transferred asset with any expense incurred on the associated liability [36]