Case Studies: Derecognition

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Financial Statement De-recognition Cases

In concept, items that can be reliably measured should be recognized as assets when they meet the definition of an asset and derecognized when they no longer do so. The conceptual framework defines an asset as an economic benefit **controlled by** the reporting entity. However, the concept of control is not consistently defined and applied in GAAP. In some cases individual accounting standards relate asset recognition (derecognition) to who can "benefit from the asset and generally can deny or regulate access to that benefit by others, for example, by permitting access only at a price". This notion of control arguably places more emphasis on authority or "power" over the asset. For financial assets this notion of control might be expressed by the legal ability to sell, pledge or exchange the financial asset. In other cases "risks and rewards" is the basis for the accounting treatment. For example, certain assets such as inventory may not be derecognized unless substantially all risks and rewards associated with that asset are conveyed to another entity. In summary, standard setters have approached the following question differently: "what matters for determining control: the ability to dictate actions and outcomes or the condition of receiving those outcomes?"

The following cases explore these concepts in particular settings. In each Part below, answer the case questions for discussion purposes. Your answers do not necessarily need to conform to current GAAP. We will discuss the synthesis questions as a group.

PART 1

Case 1

Bank Wonderful transfers a pool of its loan assets to Mega Bank in return for cash consideration. The loans will be serviced by Bank Wonderful. As part of the transfer, Bank Wonderful writes an option that allows Mega Bank to put any or all of the loans back to Bank Wonderful at their par value.

Which party has the power and which the risk and rewards? Based on your answers, how do you think each party should account for the transaction? Use the table below to document your conclusions.

	Power?	**Risk and rewards?**	**Your proposed accounting model**
Bank Wonderful			
Mega Bank			

Case 2

In return for cash consideration, Bank Wonderful agrees to provide credit protection to Mega bank for a pool of loans originated and serviced by Mega Bank. In doing so, Bank Wonderful writes an option that allows Mega bank to put to Bank Wonderful any or all of the loans at par value.

Which party has the power and which the risk and rewards? Based on your answers, how do you think each party should account for the transaction? Use the table below to document your conclusions.

	Power?	**Risk and rewards?**	**Your proposed accounting model**
Bank Wonderful			
Mega Bank			

Synthesis Questions for Part 1 (to be discussed during de-brief):

a) Are your answers influenced by whether the loans were previously held by the bank? If so, why?
b) How does current GAAP account for each of these transactions?

PART 2

Case 3

Bank Wonderful sells mortgage backed securities (MBS) to Mega Bank retaining an unconditional obligation to repurchase the securities at a future date for a fixed price.

Which party has the power and which the risk and rewards? Based on your answers, how do you think each party should account for the transaction? Use the table below to document your conclusions.

	Power?	**Risk and rewards?**	**Your proposed accounting model**
Bank Wonderful			
Mega Bank			

Synthesis Questions for Part 2 (to be discussed during de-brief):

a) Did your answers differ because the facts indicated there was a unconditional forward to repurchase in this case (versus an option to put the loans in Case 1 and Case 2)?
b) How does current GAAP account for this transaction?

PART 3

Case 4

Bank Wonderful transfers a branch building to Mega Bank in exchange for cash consideration. Bank Wonderful is unconditionally obligated to repurchase the branch building in 3 years for a fixed price.

Which party has the power and which the risk and rewards? Based on your answers, how do you think each party should account for the transaction? Use the table below to document your conclusions.

	Power?	Risk and rewards?	Your proposed accounting model
Bank Wonderful			
Mega Bank			

Case 5

Bank Wonderful enters into a forward contract to purchase a branch building from Mega Bank for a fixed price in 3 years.

Which party has the power and which the risk and rewards? Based on your answer, how do you think each party should account for the transaction? Use the table below to document your conclusions.

	Power?	Risk and rewards?	Your proposed accounting model
Bank Wonderful			
Mega Bank			

Synthesis Questions for Part 3 (to be discussed during de-brief):

a) Did the concept of control differ for financial instruments and for tangible assets?
b) Are your answers influenced by whether the branch building was previously owned by the bank now controlling the building? If so, why?
c) How does current GAAP account for each of these transactions?