Case Studies: Derecognition

Federation of Schools of Accountancy

Deloitte Foundation

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KELLEY SCHOOL OF BUSINESS

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Control Concepts

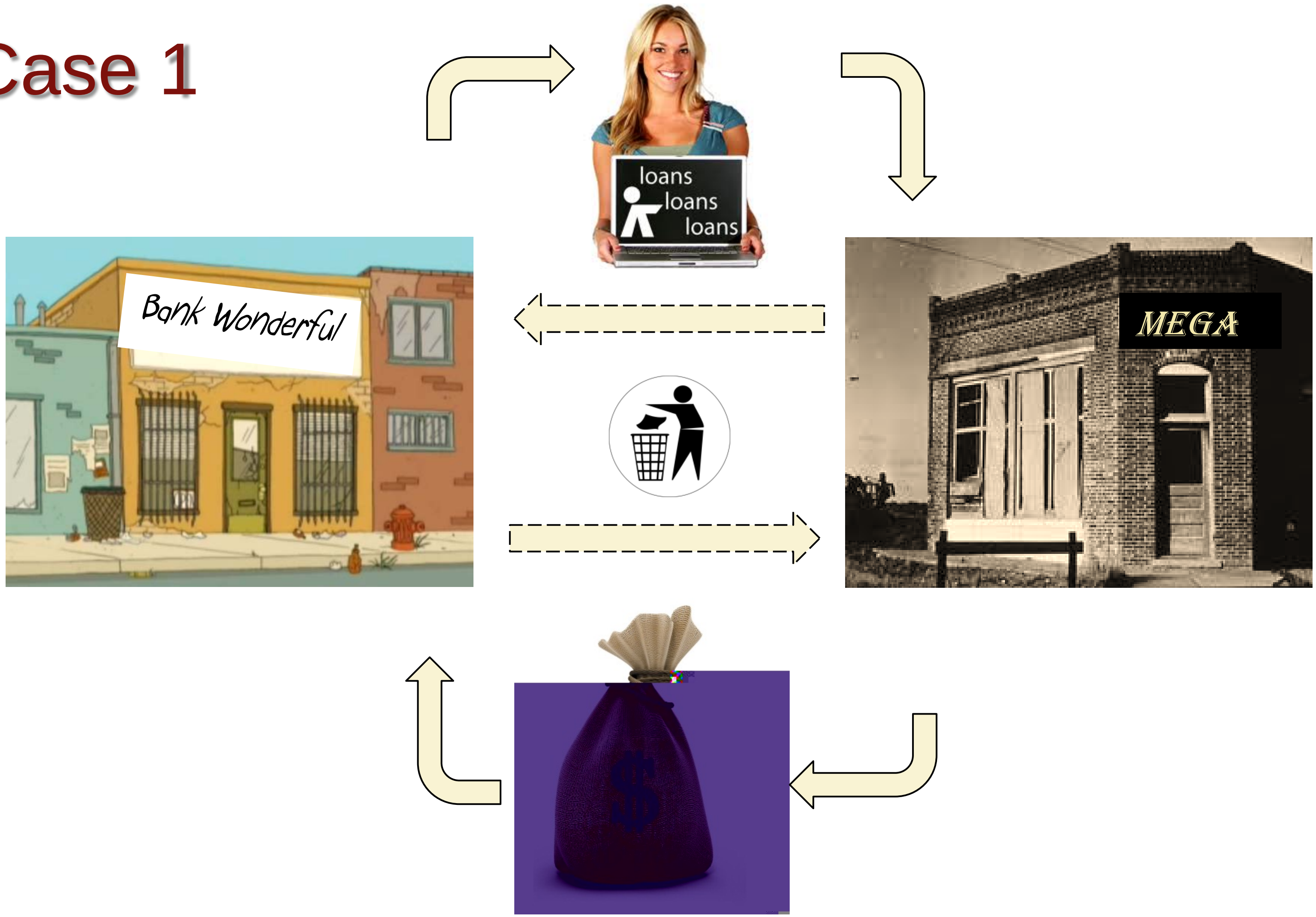
Authority

- "Power to direct"
- "Control access to"
- ?

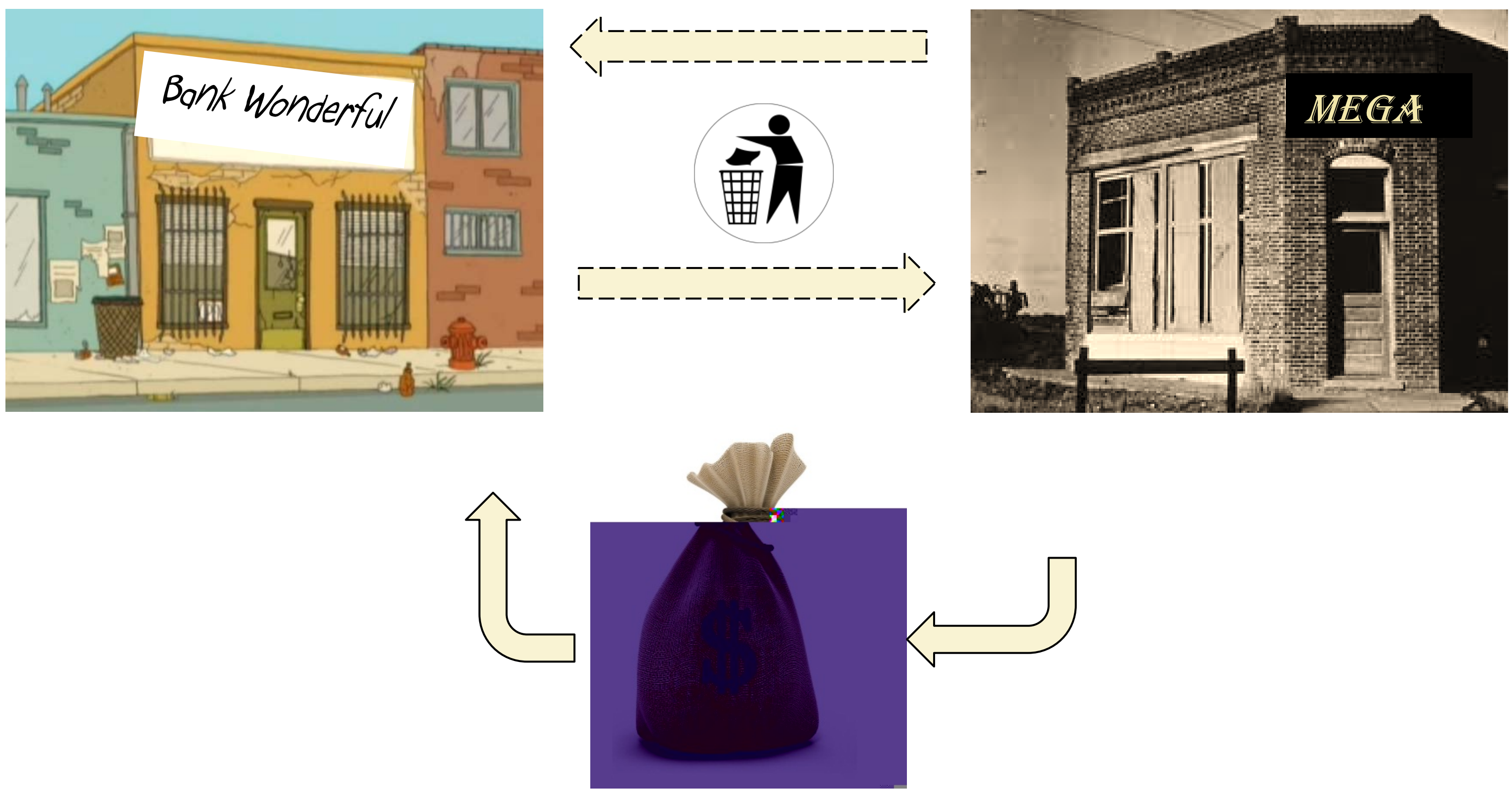
Risk and Rewards

- "Benefits from"
- "Risk/ obligations with respect to"
- ?

Case 1



Case 2



Current GAAP: what (and where) are the assets and liabilities create[illegible] the transaction?

MEGA

Case 1: recourse liability $

cash $$$

Derecognize loan assets!

loan assets $$$

Loan assets are here!

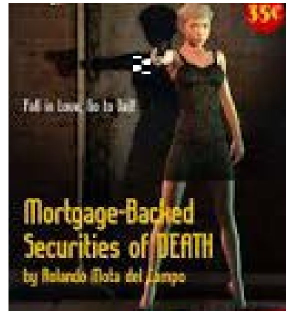
Case 2: put liability $

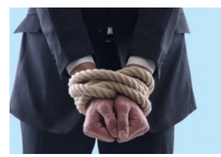
cash $

put asset $

Loan assets are here!

Case 3





Current GAAP: what (and where) are the assets and liabilities created by the transaction?

Bank Wonderful | MEGA

Case 1:

recourse liability $
cash $$$

Derecognize loan assets!

loan assets $$$

Loan assets are here!

Case 3:

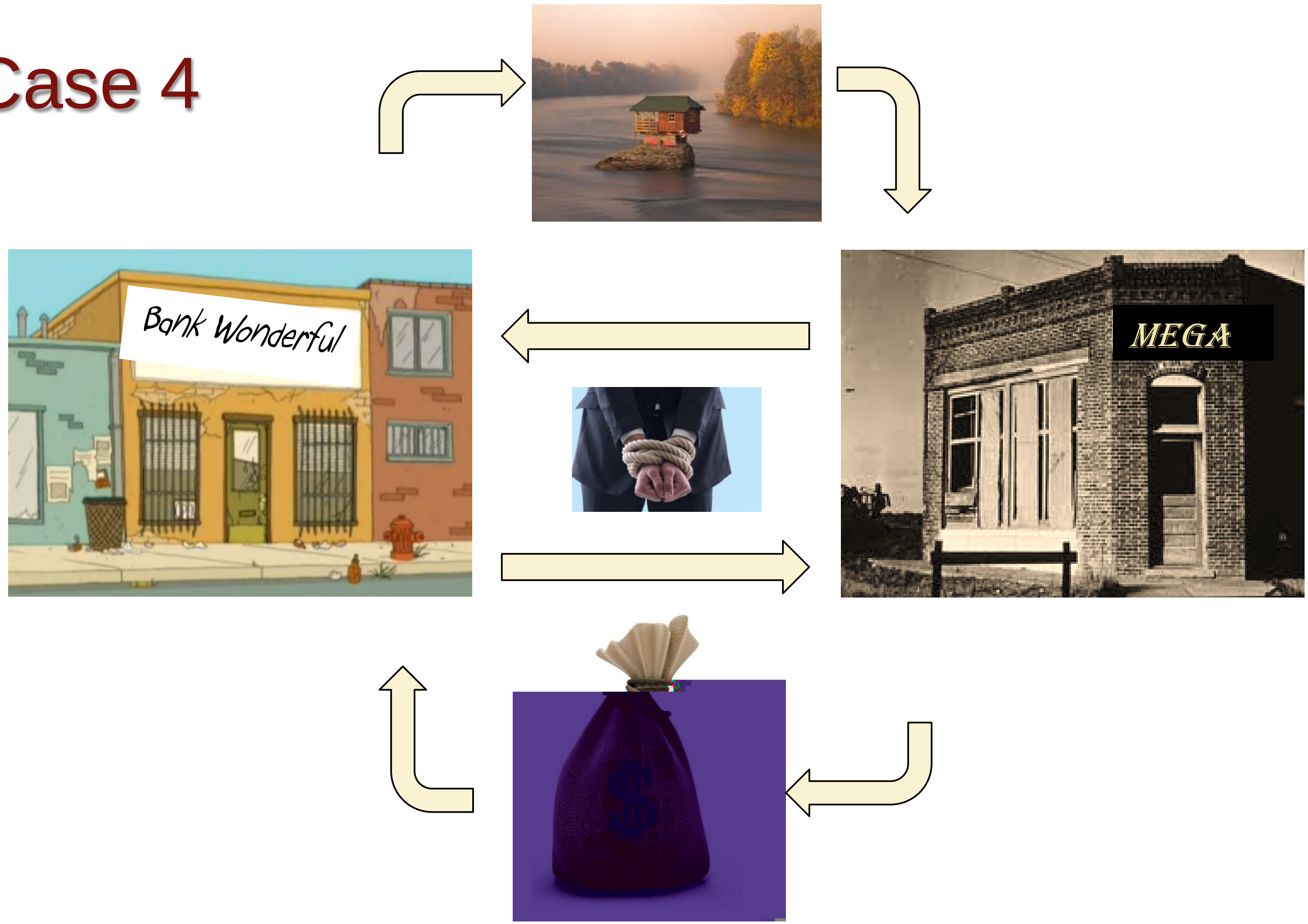
cash $$$
liability $$$

MBS assets are here!

securities asset $$$

AND MBS assets are here, too!

Case 4



Current GAAP: what (and where) are the assets and liabilities created by the transaction?

Bank Wonderful

MEGA

Case 3:

cash $$$
liability $$$

MBS assets are here!

securities asset $$$

AND MBS assets are here!

Case 4:

cash $$$
liability $$$

branch asset is here!

building $$$

AND branch asset might be here!

Case 5

Current GAAP: what (and where) are the assets and liabilities created by the transaction?

Bank Wonderful

MEGA

Case 4:

cash $$$
liability $$$

branch asset is here!

building $$$

AND branch asset might be here!

Case 5:

cash $$$
deposit liability $$$

deposit receivable $$$

branch asset is here!

Concluding Observations

- Authority and Risk/Rewards are often correlated. When they diverge, appropriate accounting likely is contentious.
- Consistently accounting for similar things requires identification of relevant similarities/differences
  - In the money put option vs. repurchase obligation
  - Financial asset vs. operating asset
- Path dependence will decrease consistency
  - e.g. If failure to transfer risk/rewards prevents derecognition (case 1), but assumption of risk/rewards is insufficient for recognition (case 2), then identical arrangements will be accounted for differently.

Concluding Observations (continued)

- Sometimes what happens on the transferor's books stays on the transferor's books and something else happens on the transferee's books.
  - a repo may be securitized borrowing on the transferor's books, but not securitized lending on the transferee's books.
- Standard setting is difficult, accounting is challenging, and banking is awesome.