Case Studies: Derecognition

Federation of Schools of Accountancy
Deloitte Foundation

Leslie Hodder, June 1, 2013
Control Concepts

Authority
• “Power to direct”
• “Control access to”
• ?

Risk and Rewards
• “Benefits from”
• “Risk/ obligations with respect to”
• ?
Case 1

Bank Wonderful

MEGA

loans

loans

loans

KELLEY SCHOOL OF BUSINESS
Case 2
Current GAAP: what (and where) are the assets and liabilities created by the transaction?

Case 1: recourse liability $ loan assets $$$
cash $$$

Case 2: put liability $ put asset $
cash $
Case 3

Bank Wonderful

Mortgage-Backed Securities of Death by Rolando Mota del Campo

MEGA

$ bag

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

Case 1: recourse liability $  loan assets $$$
         cash $$$

Case 3: cash $$$
         liability $$$
         securities asset $$$
Case 4
Current GAAP: what (and where) are the assets and liabilities created by the transaction?

Case 3: cash $$$ liability $$$

Case 4: cash $$$ liability $$$

MBS assets are here! AND MBS assets are here! Branch asset is here! AND branch asset might be here!
Case 5
Current GAAP: what (and where) are the assets and liabilities created by the transaction?

Case 4: cash $$$
liability $$$

Case 5: cash $$$
deposit liability $$$
deposit receivable $$$
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.