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Financial Instruments: General principles

4. Derecognition

4.1. Financial assets

An entity should derecognize a financial asset when:

- a. contractual rights to financial asset expire; or
- b. a financial asset has been transferred and the transfer qualifies for derecognition.

The first criterion (a) for derecognition of a financial asset is usually easy to apply. This means if the contractual right to the cash flows from the financial assets expires, the entity should remove these assets from its balance sheet. Situations are when a customer has paid off an obligation to the entity, or when an option held by the entity has expired.

The application of second criterion (b) for derecognition of a financial asset is often more complex. It relies on assessment of whether the asset has been transferred and the extent to which the risks and rewards have been retained or transferred. The following table summarizes the accounting treatment for different situations:

<i>Situation</i>	<i>Example</i>	<i>Accounting treatment</i>
Transfer substantially all risks and rewards of ownership of the transferred financial assets	<ul style="list-style-type: none">• An unconditional sale of a financial asset• A sale of a financial asset with the option to buy back at fair value at the time of purchase	Derecognition of the financial assets and recognition of gain or loss in P&L
Retain substantially all risks and rewards of the ownership of the transferred financial assets	<ul style="list-style-type: none">• A sale and repurchase agreement where the repurchase price is a fixed price or its sale price plus a lender's return• A securities lending agreement.	Continued recognition of the financial assets

4.2. Financial liabilities

The derecognition requirements for financial liabilities are different from those of financial assets. Instead, they focus on whether the financial liability has been extinguished.

(IFRS 9, par 3.3.1)

An entity shall remove a financial liability (or a part of a financial liability) from its statement of financial position when, and only when, it is extinguished—ie when the obligation specified in the contract is discharged or cancelled or expires.

In other words, when the obligation specified in the contract is discharged or cancelled or expired, the entity should remove the financial liability from its balance sheet.

For example, the expiry of a put option (i.e. a contract that gives the holder the right to sell the underlying asset at a specified price for a specified time) written by Company A requires that the company should derecognize the financial liability because this option liability has expired.

(IFRS 9, par 3.3.2)

An exchange between an existing borrower and lender of debt instruments with substantially different terms shall be accounted for as an extinguishment of the original financial liability and the recognition of a new financial liability.

Similarly, a substantial modification of the terms of an existing financial liability or a part of it (whether or not attributable to the financial difficulty of the debtor) shall be accounted for as an extinguishment of the original financial liability and the recognition of a new financial liability.

(IFRS 9, par 3.3.3)

The difference between the carrying amount of a financial liability (or part of a financial liability) extinguished or transferred to another party and the consideration paid, including any non-cash assets transferred or liabilities assumed, shall be recognised in profit or loss.

(IFRS 9, par 3.3.4)

If an entity repurchases a part of a financial liability, the entity shall allocate the previous carrying amount of the financial liability 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 repurchase. The difference between (a) the carrying amount allocated to the part derecognised and (b) the consideration paid, including any non-cash assets transferred or liabilities assumed, for the part derecognised shall be recognised in profit or loss.