

IFRS AT A GLANCE

IFRIC 9 *Reassessment of Embedded Derivatives*



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Effective Date
Periods beginning on or after 1 June 2006

BACKGROUND AND ISSUE

- IAS 39 *Financial Instruments: Recognition and Measurement* requires an entity, when it first becomes party to a contract, to assess whether any embedded derivatives contained in the contract are required to be separated from the host contract and accounted for as derivatives under IAS 39. IFRIC 9 addresses the following issues:
 - Does IAS 39 require such an assessment to be made only when the entity first becomes a party to the contract, or should the assessment be reconsidered throughout the life of the contract?
 - Should a first-time adopter make its assessment on the basis of the conditions that existed when the entity first became a party to the contract, or those prevailing when the entity adopts IFRSs for the first time?

SCOPE

- IFRIC 9 applies to all embedded derivatives within the scope of IAS 39
- IFRIC 9 does not address remeasurement issues arising from a reassessment of embedded derivatives
- IFRIC 9 does not address the acquisition of contracts with embedded derivatives in a business combination nor their possible reassessment at the date of acquisition.

CONSENSUS

- An entity assesses whether an embedded derivative is required to be separated from the host contract and accounted for as a derivative when the entity first becomes a party to the contract
- Subsequent reassessment is prohibited unless there is:
 - A change in the terms of the contract that significantly modifies the cash flows that otherwise would be required under the contract
 - A reclassification of a financial asset out of the fair value through profit or loss model, in which case an assessment is required.
- An entity determines whether a modification to cash flows is significant by considering the extent to which the expected future cash flows associated with the embedded derivative, the host contract, or both have changed and whether the change is significant relative to the previously expected cash flows on the contract
- The assessment whether an embedded derivative is required to be separated from the host contract and accounted for as a derivative on reclassification of a financial asset out of the fair value through profit or loss category in accordance with paragraph 7 is required to be made on the basis of the circumstances that existed on the later of:
 - When the entity first became a party to the contract
 - A change in the terms of the contract that significantly modified the cash flows that otherwise would have been required under the contract.

For the purpose of this assessment paragraph 11(c) of IAS 39 is not applied (ie the hybrid (combined) contract is treated as if it had not been measured at fair value with changes in fair value recognised in profit or loss). If an entity is unable to make this assessment the hybrid (combined) contract remains classified as at fair value through profit or loss in its entirety

- A first-time adopter assesses whether an embedded derivative is required to be separated from the host contract and accounted for as a derivative on the basis of the conditions that existed at the later of the date it first became a party to the contract and the date a reassessment is required.

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