IFRIC Interpretation 9

Reassessment of Embedded Derivatives

This version includes amendments resulting from IFRSs issued up to 31 December 2009.

IFRIC 9 *Reassessment of Embedded Derivatives* was developed by the International Financial Reporting Interpretations Committee and issued by the International Accounting Standards Board in March 2006.

IFRIC 9 has been amended by the following IFRSs:

- IFRS 3 *Business Combinations* (as revised in January 2008)*
- *Embedded Derivatives* (Amendments to IFRIC 9 and IAS 39) (issued March 2009)*
- *Improvements to IFRSs* (issued April 2009).*

The Basis for Conclusions on IFRIC 9 has been amended to reflect the issue of IFRS 9 *Financial Instruments* in November 2009.†

* effective date 1 July 2009

† effective date 1 January 2013 (earlier application permitted)

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REASSESSMENT OF EMBEDDED DERIVATIVES

IFRIC Interpretation 9 *Reassessment of Embedded Derivatives* (IFRIC 9) is set out in paragraphs 1–11. IFRIC 9 is accompanied by a Basis for Conclusions. The scope and authority of Interpretations are set out in paragraphs 2 and 7–17 of the *Preface to International Financial Reporting Standards*.

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Reassessment of Embedded Derivatives

References

- IAS 39 *Financial Instruments: Recognition and Measurement*
- IFRS 1 *First-time Adoption of International Financial Reporting Standards*
- IFRS 3 *Business Combinations*

Background

1 IAS 39 paragraph 10 describes an embedded derivative as 'a component of a hybrid (combined) instrument that also includes a non-derivative host contract—with the effect that some of the cash flows of the combined instrument vary in a way similar to a stand-alone derivative.'

2 IAS 39 paragraph 11 requires an embedded derivative to be separated from the host contract and accounted for as a derivative if, and only if:

(a) the economic characteristics and risks of the embedded derivative are not closely related to the economic characteristics and risks of the host contract;

(b) a separate instrument with the same terms as the embedded derivative would meet the definition of a derivative; and

(c) the hybrid (combined) instrument is not measured at fair value with changes in fair value recognised in profit or loss (ie a derivative that is embedded in a financial asset or financial liability at fair value through profit or loss is not separated).

Scope

3 Subject to paragraphs 4 and 5 below, this Interpretation applies to all embedded derivatives within the scope of IAS 39.

4 This Interpretation does not address remeasurement issues arising from a reassessment of embedded derivatives.

5 This Interpretation does not apply to embedded derivatives in contracts acquired in:

(a) a business combination (as defined in IFRS 3 *Business Combinations* (as revised in 2008));

(b) a combination of entities or businesses under common control as described in paragraphs B1–B4 of IFRS 3 (revised 2008); or

(c) the formation of a joint venture as defined in IAS 31 *Interests in Joint Ventures*

or their possible reassessment at the date of acquisition.*

* IFRS 3 (as revised in 2008) addresses the acquisition of contracts with embedded derivatives in a business combination.

Issues

6 IAS 39 requires an entity, when it first becomes a 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 the Standard. This Interpretation addresses the following issues:

(a) 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?

(b) 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?

Consensus

7 An entity shall assess 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 either (a) a change in the terms of the contract that significantly modifies the cash flows that otherwise would be required under the contract or (b) a reclassification of a financial asset out of the fair value through profit or loss category, in which cases 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.

7A 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 shall be made on the basis of the circumstances that existed on the later date of:

(a) when the entity first became a party to the contract; and

(b) 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 shall not be applied (ie the hybrid (combined) contract shall be 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 shall remain classified as at fair value through profit or loss in its entirety.

8 A first-time adopter shall assess 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 by paragraph 7.

Effective date and transition

9 An entity shall apply this Interpretation for annual periods beginning on or after 1 June 2006. Earlier application is encouraged. If an entity applies the Interpretation for a period beginning before 1 June 2006, it shall disclose that fact. The Interpretation shall be applied retrospectively.

10 *Embedded Derivatives* (Amendments to IFRIC 9 and IAS 39) issued in March 2009 amended paragraph 7 and added paragraph 7A. An entity shall apply those amendments for annual periods ending on or after 30 June 2009.

11 Paragraph 5 was amended by *Improvements to IFRSs* issued in April 2009. An entity shall apply that amendment prospectively for annual periods beginning on or after 1 July 2009. If an entity applies IFRS 3 (as revised in 2008) for an earlier period, it shall apply the amendment for that earlier period and disclose that fact.

