

# IFRS Briefing Sheet

## *Embedded Derivatives – Amendments to IFRIC 9 and IAS 39*

March 2009, **Issue 128**

This IFRS Briefing Sheet summarises the International Accounting Standards Board's (IASB or Board) *Embedded Derivatives – Amendments to IFRIC 9 and IAS 39*, which was published on 12 March 2009.

Amendments require entities to assess whether they need to separate an embedded derivative from a hybrid (combined) financial instrument when financial assets are reclassified out of the fair value through profit or loss category.

When the fair value of an embedded derivative that would be separated cannot be measured reliably, the reclassification of the hybrid (combined) financial asset out of the fair value through profit or loss category is not permitted.

Amendments are applicable for 2009 calendar year-ends.

### **Background**

The amendments to IAS 39 *Financial Instruments: Recognition and Measurement* and IFRS 7 *Financial Instruments: Disclosures*, which were issued by the IASB in October 2008, permit an entity to reclassify certain non-derivative financial assets that were previously held for trading out of the fair value through profit or loss category in certain circumstances. Constituents alerted the Board to a potential diversity in practice related to

the interaction of these amendments with IFRIC 9 *Reassessment of Embedded Derivatives*.

IFRIC 9, prior to the amendments, stated that once the embedded derivative separation assessment under IAS 39 was done initially, it was not performed again unless there was a change in the terms of the contract that significantly modified the original cash flows. As a result IFRIC 9 might have been interpreted as prohibiting the separation of an embedded derivative on the reclassification of a hybrid (combined) financial asset out of the fair value through profit or loss category, unless there was a concurrent change in its contractual terms.

### **Summary of the Amendments**

The Board responded to this issue by amending IFRIC 9 and IAS 39. As a result, entities are required to:

- assess whether an embedded derivative is required to be separated from a host contract when the entity reclassifies a hybrid (combined) financial asset out of the fair value through profit or loss category
- make such an assessment on the basis of the circumstances that existed when the entity first became a party to the contract, or, if later, when there was a change

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- in the contract that significantly modified the cash flows
- determine whether the fair value of the separated embedded derivative can be measured reliably; if not, the entire hybrid (combined) financial asset must remain in the fair value through profit or loss category.

When an entity performs the assessment as required by the amendments it does not apply paragraph 11(c) of IAS 39, which states that separation of an embedded

derivative from the host contract is required only if the hybrid (combined) instrument is not measured at fair value through profit or loss.

#### **Effective Date**

The amendments are applicable for annual periods ending on or after 30 June 2009, which is a change compared to the exposure draft published December 2008 that proposed an effective date for annual periods ending on or after 15 December 2008.

If you would like further information on any of the matters discussed in this issue of *IFRS Briefing Sheet*, please talk to your usual local KPMG contact or call any of KPMG firms' offices.

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