

Reassessment of Embedded Derivatives

This version of INT SB-FRS 109 does **not** include amendments that are effective for annual periods beginning **after** 1 January 2015.

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Interpretation of Statutory Board Financial Reporting Standard 109 *Reassessment of Embedded Derivatives* (INT SB-FRS 109) is set out in paragraphs 1–12. The scope and authority of Interpretations are set out in the *Preface to Statutory Board Financial Reporting Standards*.

Interpretation of Statutory Board Financial Reporting Standard 109

Reassessment of Embedded Derivatives

References

- SB-FRS 39 *Financial Instruments: Recognition and Measurement*
- SB-FRS 101 *First-time Adoption of Financial Reporting Standards*
- SB-FRS 103 *Business Combinations*

Background

- 1 SB-FRS 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 SB-FRS 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 SB-FRS 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 SB-FRS 103 *Business Combinations* (as revised in 2009));
 - (b) a combination of entities or businesses under common control as described in paragraphs B1–B4 of SB-FRS 103 (revised 2009); or
 - (c) the formation of a joint venture as defined in SB-FRS 111 *Joint Arrangements* or their possible reassessment at the date of acquisition.¹

¹ SB-FRS 103 (as revised in 2009) addresses the acquisition of contracts with embedded derivatives in a business combination.

Issues

- 6 SB-FRS 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 SB-FRS 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 SB-FRSs 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 SB-FRS 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 INT SB-FRS 109 and SB-FRS 39) issued in April 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 SB-FRSs* issued in June 2009. An entity shall apply that amendment prospectively for annual periods beginning on or after 1 July 2009. If an entity applies SB-FRS 103 (as revised in 2009) for an earlier period, it shall apply the amendment for that earlier period and disclose that fact.
- 12 SB-FRS 111, issued in September 2011, amended paragraph 5(c). An entity shall apply that amendment when it applies SB-FRS 111.