

## **New Zealand Equivalent to IFRIC Interpretation 9**

### **Reassessment of Embedded Derivatives (NZ IFRIC 9)**

**Issued May 2006 and incorporates amendments up to November 2007.**

This Interpretation was issued by the Financial Reporting Standards Board of the New Zealand Institute of Chartered Accountants\* and approved by the Accounting Standards Review Board in May 2006 under the Financial Reporting Act 1993.

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\* The New Zealand Institute of Chartered Accountants is the operating name of the Institute of Chartered Accountants of New Zealand, a body established under the Institute of Chartered Accountants of New Zealand Act 1996. All references to the New Zealand Institute of Chartered Accountants, or to the Institute, in this document mean the Institute of Chartered Accountants of New Zealand.

NZ IFRIC 9

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#### **IFRIC BASIS FOR CONCLUSIONS**

## HISTORY OF AMENDMENTS

### Table of Pronouncements – NZ IFRIC 9 *Reassessment of Embedded Derivatives*

This table lists the pronouncements establishing and amending NZ IFRIC 9. The table is based on amendments approved as at 30 November 2007.

Pronouncements	Date approved (ASRB approval)	Early operative date	Effective date (annual reporting periods... on or after ...)
NZ IFRIC 9 <i>Reassessment of Embedded Derivatives</i>	May 2006 (Approval 81)	1 June 2006 Early application encouraged	1 Jan 2007

New Zealand Equivalent to IFRIC Interpretation 9 *Reassessment of Embedded Derivatives* (NZ IFRIC 9) is set out in paragraphs 1-9.

NZ IFRIC 9 is based on IFRIC 9 *Reassessment of Embedded Derivatives* (IFRIC 9). NZ IFRIC 9 should be read in the context of the IFRIC's Basis for Conclusions on IFRIC 9 and the Illustrative Example for IFRIC 9. The scope and authority of Interpretations are set out in paragraphs 2 and 7-17 of the *Preface to International Financial Reporting Standards* and paragraph 13 of the *New Zealand Preface*.

**Differential Reporting**

Qualifying entities must comply with all the provisions in NZ IFRIC 9.

## **New Zealand Equivalent to IFRIC Interpretation 9**

### **Reassessment of Embedded Derivatives (NZ IFRIC 9)**

#### **References**

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

#### **BACKGROUND**

- 1 NZ 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 NZ 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 NZ IAS 39.
- 4 This Interpretation does not address remeasurement issues arising from a reassessment of embedded derivatives.
- 5 This Interpretation does not address the acquisition of contracts with embedded derivatives in a business combination nor their possible reassessment at the date of acquisition.

#### **ISSUE**

- 6 NZ IAS 39 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 the Standard. This Interpretation addresses the following issues:

- (a) Does NZ 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 the *New Zealand Equivalents to International Financial Reporting Standards* 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 a change in the terms of the contract that significantly modifies the cash flows that otherwise would be required under the contract, in which case reassessment 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.
- 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 This Interpretation becomes operative for an entity's financial statements that cover annual accounting periods beginning on or after 1 January 2007. For entities which elect to comply with NZ IFRS 1 *First-time Adoption of New Zealand Equivalents to International Financial Reporting Standards* for an annual accounting period beginning on or after 1 January 2005 and before 1 January 2007, this Interpretation becomes operative for annual accounting periods beginning on or after 1 June 2006. Early application is encouraged. If an entity applies this Interpretation to a period beginning before 1 June 2006, it shall disclose that fact. The Interpretation shall be applied retrospectively.