New Zealand Equivalent to IFRIC Interpretation 9

Reassessment of Embedded Derivatives
(NZ IFRIC 9)

Issued May 2006 and incorporates amendments to 30 November 2012 other than consequential amendments resulting from early adoption of NZ IFRS 9 *Financial Instruments* (2010)

This Interpretation was issued by the New Zealand Accounting Standards Board of the External Reporting Board pursuant to section 24(1)(a) of the Financial Reporting Act 1993.

This Interpretation is a Regulation for the purposes of the Regulations (Disallowance) Act 1989.

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New Zealand Equivalent to IFRIC Interpretation 9 *Reassessment of Embedded Derivatives* (NZ IFRIC 9) is set out in paragraphs 1–NZ 12.1.

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.

Any New Zealand additional material is shown with either "NZ" or "RDR" preceding the paragraph number.

Reduced Disclosure Regime

Tier 2 for-profit entities must comply with all the provisions in NZ IFRIC 9.

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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

NZ 2.1 This Interpretation applies to Tier 1 and Tier 2 for-profit entities.

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 apply to embedded derivatives in contracts acquired in:

(a) a business combination (as defined in NZ IFRS 3 as revised in 2008);

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

(c) the formation of a joint venture as defined in NZ IFRS 11 *Joint Arrangements*

or their possible reassessment at the date of acquisition.[1]

Issue

6 NZ 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 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?

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

(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 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 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.

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 NZ 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 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.

10 *Embedded Derivatives* (Amendments to NZ IFRIC 9 and NZ 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 NZ IFRSs* issued in May 2009. An entity shall apply that amendment prospectively for annual periods beginning on or after 1 July 2009. If an entity applies NZ IFRS 3 (as revised in 2008) for an earlier period, it shall apply the amendment for that earlier period and disclose that fact.

12 NZ IFRS 11, issued in June 2011, amended paragraph 5(c). An entity shall apply that amendment when it applies NZ IFRS 11.

NZ 12.1 *Framework: Tier 1 and Tier 2 For-profit Entities*, issued in November 2012, amended extant NZ IFRSs by deleting any public benefit entity paragraphs, deleting any differential reporting concessions, adding scope paragraphs for Tier 1 and Tier 2 for-profit entities and adding disclosure concessions for Tier 2 entities. It made no changes to the requirements for Tier 1 entities. A Tier 2 entity may elect to apply the disclosure concessions for annual periods beginning on or after 1 December 2012. Early application is permitted.

IFRIC Basis for Conclusions

BC1–BC13 [Paragraphs BC1–BC13 do not form part of NZ IFRIC 9.]

HISTORY OF AMENDMENTS

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

This table lists the pronouncements establishing and substantially amending NZ IFRIC 9. The table is based on amendments approved as at 30 November 2012 other than consequential amendments resulting from early adoption of NZ IFRS 9 *Financial Instruments* (2010).

Pronouncements	**Date approved**	**Early operative date**	**Effective date (annual reporting periods… on or after …)**
NZ IFRIC 9 *Reassessment of Embedded Derivatives*	May 2006	1 June 2006 Early application encouraged	1 Jan 2007
NZ IFRS 3 *Business Combinations* (revised 2008)	Feb 2008	Early application permitted	1 Jan 2009
Embedded Derivatives (Amendments to NZ IFRIC 9 and NZ IAS 39 *Financial Instruments: Recognition and Measurement*)	Mar 2009	Annual periods ending on or after 30 June 2009	30 June 2009
Improvements to NZ IFRSs	May 2009	Early application permitted	1 July 2009
NZ IFRS 11 *Joint Arrangements*	June 2011	Early application permitted	1 Jan 2013
Framework: Tier 1 and Tier 2 For-profit Entities[2]	Nov 2012	Early application permitted	1 Dec 2012

Table of Amended Paragraphs in NZ IFRIC 9		
Paragraph affected	**How affected**	**By … [date]**
Paragraph 5	Footnote added	NZ IFRS 3 [Feb 2008]
Paragraph 5	Amended	*Improvements to NZ IFRSs* [May 2009]
Paragraph 5(c)	Amended	NZ IFRS 11 [June 2011]
Paragraph 7	Amended	*Embedded Derivatives* [Mar 2009]
Paragraph 7A	Added	*Embedded Derivatives* [Mar 2009]
Paragraph 10	Added	*Embedded Derivatives* [Mar 2009]
Paragraph 11	Added	*Improvements to NZ IFRSs* [May 2009]
Paragraph 12	Added	NZ IFRS 11 [June 2011]
Paragraph NZ 12.1	Added	*Framework: Tier 1 and Tier 2 For-profit Entities* [Nov 2012]

[2] This pronouncement amended extant NZ IFRSs by (i) deleting any public benefit entity paragraphs, (ii) deleting any differential reporting paragraphs, (iii) adding scope paragraphs for Tier 1 and Tier 2 for-profit entities, and (iv) adding RDR disclosure concessions.