Amendments to HK(IFRIC) – Int 9 *Reassessment of Embedded Derivatives* and HKAS 39 *Financial Instruments: Recognition and Measurement* – Embedded Derivatives

HKICPA Standard Setting Department Staff Summary (May 2009)

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The HKICPA Standard Setting Department welcomes your comments and feedback, which should be sent to commentletters@hkicpa.org.hk.

Introduction

1. Amendments to HK(IFRIC) – Int 9 *Reassessment of Embedded Derivatives* and HKAS 39 *Financial Instruments: Recognition and Measurement* – Embedded Derivatives clarify the accounting treatment of embedded derivatives for entities that make use of the reclassification amendment issued in October 2008.

2. Entities shall apply these amendments retrospectively for annual periods ending on or after 30 June 2009.

Reasons for issuing Amendments to HK(IFRIC) – Int 9 and HKAS 39

3. The objective of the Hong Kong Institute of Certified Public Accountants (HKICPA) in issuing Amendments to HK(IFRIC) – Int 9 and HKAS 39 is to maintain international convergence arising from the issuance of Amendments to IFRIC 9 and IAS 39 by the International Accounting Standards Board (IASB).

4. The amendments form part of the response to views received in the round-table discussions organised by the IASB and the US Financial Accounting Standards Board in November and December 2008. Participants asked the IASB to clarify the accounting treatment of embedded derivatives in the reclassification amendments in order to avoid divergence in practice.

5. The amendments clarify that on reclassification of a financial asset out of the "at fair value through profit or loss" category all embedded derivatives have to be assessed and, if necessary, separately accounted for in financial statements.

Main features of the Amendments

6. The amendments clarify that reassessment of embedded derivatives is prohibited, except in the following two circumstances:

   i) when there is a change in the terms of the contract that significantly modifies the cash flows that otherwise would be required under the contract; or

ii) when a reclassification of a financial asset out of the fair value through profit or loss category.

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

   i) when the entity first became a party to the contract; and
   ii) a change in the terms of the contract that significantly modified the cash flows that otherwise would have been required under the contract.

8. The amendments also require that if the fair value of an embedded derivative that would have to be separated on reclassification cannot be reliably measured, the entire hybrid financial instrument must remain classified as at fair value through profit or loss.

Other references on Amendments to IFRIC 9 and IAS 39

1. Deloitte IAS Plus Update on clarification regarding assessment of embedded derivatives
   http://www.iasplus.com/iasplus/0903ifric9ias39.pdf

2. Ernst & Young "Supplement to IFRS outlook" Embedded Derivatives: Amendments to IFRIC 9 and IAS 39
   http://www.ey.com/Global/assets.nsf/International/IFRS_Supplement_to_IFRS_Outlook_issue_no32/$file/Supplement_32.pdf

3. KPMG IFRS Briefing Sheet on *Embedded Derivatives – Amendments to IFRIC 9 and IAS 39*
   http://www.kpmg.com.hk/en/virtual_library/Audit/IFRS_briefingsheet/IFRSBS09128.pdf

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