PROPOSED INTERPRETATION OF FINANCIAL REPORTING STANDARD & PROPOSED FINANCIAL REPORTING STANDARD	ED INT FRS 109 & FRS 39

Exposure Draft

Embedded Derivatives

Proposed amendments to INT FRS 109 and FRS 39

Comments to be received by 9 January 2009

This exposure draft *Embedded Derivatives* (proposed amendments to INT FRS 109 and FRS 39 is issued by the Accounting Standards Council (ASC) for comment only and does not necessarily represent the views of ASC. The proposals may be modified in the light of the comments received before being issued in final form as amendments to INT FRS 109 and FRS 39.

Comments are most helpful if they indicate the specific paragraph or group of paragraphs to which they relate, clearly explain the problem and provide a suggestion for alternative wording with supporting reasoning.

Comments should be submitted in writing, so as to be received by 9 January 2009 preferably by email to MOF_Feedback_ASC@mof.gov.sg or addressed to:

Accounting Standards Council
c/o Ministry of Finance
100 High Street #10-01
The Treasury
Singapore 179434

CONTENTS

Introduction

1 IFRIC 9 *Reassessment of Embedded Derivatives* was developed by the International Financial Reporting Interpretations Committee and issued by the International Accounting Standards Board (IASB) in 2006 with mandatory application for annual periods beginning on or after 1 June 2006. IAS 39 *Financial Instruments: Recognition and Measurement* was revised in 2003 with mandatory application for annual periods beginning on or after 1 January 2005. This exposure draft contains proposals by the Board to amend IFRIC 9 and IAS 39. The proposals would require an entity 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.

2 Following the issue of *Reclassification of Financial Assets* (Amendments to IAS 39 and IFRS 7 *Financial Instruments: Disclosures*) in October 2008, constituents alerted the IASB to a possible unintended consequence of those amendments related to the interaction between the amendments and IFRIC 9. Some of those taking part in the public round-table meetings held by the Board and the US Financial Accounting Standards Board in November and December 2008 in response to the global financial crisis also raised that issue. They asked the Board to consider amending IFRSs to prevent any practice developing whereby, following reclassification of a financial asset, embedded derivatives that should be separately accounted for are not.

3 This exposure draft proposes amendments that would require:

(a) an entity 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.

(b) the assessment to be made on the basis of the circumstances that existed when the entity first became a party to the contract.

(c) that if the fair value of an embedded derivative that would have to be separated cannot be reliably measured, the entire hybrid financial instrument must remain in the fair value through profit or loss category.

Invitation to comment

The ASC invites comments on the amendments to INT FRS 109 and FRS 39 proposed in this exposure draft, particularly on the questions set out below. Comments are helpful if they:

(a) comment on the questions as stated,

(b) indicate the specific paragraph or group of paragraphs to which they relate,

(c) contain a clear rationale, and

(d) include any alternative the ASC should consider, if applicable.

Respondents need not comment on all of the questions and are encouraged to comment on any additional issues that, in their view, warrant consideration.

ASC is not requesting comments on matters not addressed in this exposure draft.

Comments should be submitted in writing so as to be received no later than **9 January 2009**.

Question 1

The exposure draft clarifies that an entity must 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.

Do you agree with that clarification? If not, why? What would you propose instead, and why?

Question 2

The exposure draft requires the assessment to be made on the basis of the circumstances that existed when the entity first became a party to the contract.

Do you agree with that proposal? If not, why? What would you propose instead, and why?

Question 3

The exposure draft proposes that if the fair value of an embedded derivative that would have to be separated cannot be reliably measured, the entire hybrid (combined) financial instrument must remain in the fair value through profit or loss category.

Do you agree with that proposal? If not, why? What would you propose instead, and why?

Question 4

Do you agree with the proposed effective date? If not, why? What would you propose instead, and why?

Question 5

Are the transition requirements appropriate? If not, why? What would you propose instead, and why?

PROPOSED INTERPRETATION OF FINANCIAL REPORTING STANDARD & PROPOSED FINANCIAL REPORTING STANDARD	**ED INT FRS 109 & FRS 39**

Proposed amendments to Interpretation of Financial Reporting Standard 109 *Reassessment of Embedded Derivatives*

Paragraph 7 is amended (new text is underlined and deleted text is struck through). Paragraphs 7A and 10 are added.

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 ~~re~~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 when the entity first became a party to the contract.

Effective date and transition

10 An entity shall apply amended paragraph 7 and paragraph 7A for annual periods ending on or after [15 December 2008].

Proposed amendments to Financial Reporting Standard 39 *Financial Instruments: Recognition and Measurement*

Paragraph 12 is amended (new text is underline). Paragraph 103J is added.

Embedded derivatives

12 **If an entity is required by this Standard to separate an embedded derivative from its host contract, but is unable to measure the embedded derivative separately either at acquisition or at the end of a subsequent financial reporting period, it shall designate the entire hybrid (combined) contract as at fair value through profit or loss. <u>Similarly, if an entity is unable to measure separately the embedded derivative that would have to be separated on reclassification of a hybrid (combined) contract out of the fair value through profit or loss category, that reclassification is prohibited. In such circumstances the hybrid (combined) contract remains classified as at fair value through profit or loss in its entirety.</u>**

Effective date and transition

103J An entity shall apply amended paragraph 12 for annual periods ending on or after [15 December 2008].