

IAS 39 Financial Instruments: Recognition and Measurement (Jan 2007)

Definition of a derivative: Indexation on own EBITDA or own revenue

In July 2006 the IFRIC published a tentative agenda decision that explained why it had decided not to issue guidance on whether a contract that is indexed to an entity's own revenue or own earnings before interest, tax, depreciation and amortisation (EBITDA) is (or might contain) a derivative. The tentative agenda decision addressed two issues:

- whether the exclusion from the definition of a derivative of contracts linked to non-financial variables that are specific to a party to the contract applies only to insurance contracts
- whether EBITDA or revenue is a financial or non-financial variable.

The tentative agenda decision concluded that:

- the exclusion from the definition of a derivative of contracts linked to non-financial variables that are specific to a party to the contract is not restricted to insurance contracts, on the basis of the current drafting of the standard; and
- although IAS 39 is unclear whether revenue or EBITDA is a financial or non-financial variable, the IFRIC would not take this issue onto its agenda because it was unlikely to reach a consensus on a timely basis.

At the January 2007 meeting, the IFRIC decided to withdraw the tentative agenda decision. Having reconsidered the issue, the IFRIC noted that taking no action would allow continued significant diversity in practice regarding how financial and non-financial variables were determined.

Consequently, the IFRIC directed the staff to refer the issue to the Board. The IFRIC recommended that the Board should amend IAS 39 (possibly as part of the annual improvements process) to limit to insurance contracts the exclusion from the definition of a derivative of contracts linked to non-financial variables that are specific to a party to the contract.