30 Cannon Street, London EC4M 6XH, United Kingdom
Tel: +44 (0)20 7246 6410 Fax: +44 (0)20 7246 6411
Email: iasb@iasb.org Website: www.iasb.org

International Accounting Standards Board

This observer note is provided as a convenience to observers at IFRIC meetings, to assist them in following the IFRIC's discussion. Views expressed in this document are identified by the staff as a basis for the discussion at the IFRIC meeting. This document does not represent an official position of the IFRIC. Decisions of the IFRIC are determined only after extensive deliberation and due process. IFRIC positions are set out in Interpretations.

Note: The observer note is based on the staff paper prepared for the IFRIC. Paragraph numbers correspond to paragraph numbers used in the IFRIC paper. However, because the observer note is less detailed, some paragraph numbers are not used.

INFORMATION FOR OBSERVERS

IFRIC meeting: **July 2007, London**

Project: **Comments on a tentative agenda decision – Scope of paragraph 11A of IAS 39 (Agenda Paper 7E(i))**

---

1. The IFRIC received six comment letters on this tentative agenda decision (see Agenda Paper 7E Attachments 1-6).

2. Major reasons against the tentative agenda decision include:

- **Reason 1 –** Paragraph 11 of IAS 39 requires an entity to separate a derivative embedded in any contract (whether or not the contract is within the scope of IAS 39) provided that certain conditions are met. Paragraph 12 of IAS 39 requires an entity to designate an entire contract, that includes a derivative that is required to be separately accounted for, as at fair value through profit or loss if the entity is not able to measure the embedded derivative separately. Therefore, paragraph 12 of IAS 39 also covers hybrid contracts that contain hosts outside the scope of IAS 39. Consequently, some respondents believed that paragraph 11A of IAS 39, which is located in the middle of paragraphs 11 and 12 of IAS 39, should be applicable to all contracts that contain one or more embedded derivatives, regardless of whether the hosts are within the scope of IAS 39.

- **Reason 2 –** The wording in IAS 39 paragraph 11A is ambiguous. IAS 39 paragraph 11A uses the term 'contract'. Therefore, some respondents believed that the term 'contract' applies to all contracts (whether or not the contract is within the scope of IAS 39).

- **Reason 3 –** Some respondents noted that the IFRIC's argument for its tentative decision is that the scope of paragraph 11A of IAS 39 should not be broader than the overall scope of IAS 39, as set out in paragraphs 2 – 7 of IAS 39. However, some respondents believed that such a principle is not articulated in IAS 39.

- **Reason 4 –** Some respondents noted diversity in practice.

3. The staff would like to remind the IFRIC some of the arguments for its tentative agenda decision.

4. The fair value designation option in IAS 39 applies **to a financial asset or financial liability**. Paragraph 9 of IAS 39 states:

> '**A financial asset or financial liability** at fair value through profit or loss is a financial asset or financial liability that meets either of the following conditions.
>
> (a) It is classified as held for trading. **A financial asset or financial liability** is classified as held for trading if it is …
> (b) Upon initial recognition **it** is designated by the entity as at fair value through profit or loss. An entity may use this designation **only when permitted by paragraph 11A**, or when doing so results in more relevant information, …'

5. Based on paragraph 9 of IAS 39, paragraph 11A of IAS 39 is merely one of the conditions to qualify for the fair value designation option. Given paragraph 9 of IAS 39 only applies to a financial asset or financial liability, paragraph 11A of IAS 39, that is one of the conditions to qualify for the fair value designation option, should only be applied to financial instrument contracts.

6. Some respondents pointed out that paragraphs 11 and 12 of IAS 39 are applicable to all contracts (financial instrument contracts and non-financial instruments). Consequently, they believed that paragraph 11A of IAS 39 should also be applicable to all contracts. However, the reason why paragraph 11 of IAS 39 is applicable to all contracts is to ensure embedded derivatives in non-financial instrument contracts with characteristics similar to standalone derivatives to be accounted for in the same way as standalone derivative contracts. Such a requirement does not mean that the fair value designation option can also be applicable to all contracts.

7. As pointed out by another comment letter (see Attachment 6 to Agenda paper 7E), allowing paragraph 11A of IAS 39 to apply to all contracts would override all measurement requirements in other IFRSs. This is clearly **not the intent of the IASB** when it included the fair value designation option in IAS 39.

8. Similarly, another comment letter (see Attachment 1 to Agenda Paper 7E) agreed with the tentative agenda decision that the fair value designation option should **not** be applied to contracts outside the scope of IAS 39. However, the

constituent is concerned with whether the tentative agenda decision reflects how IAS 39 is currently phrased and structured.

Staff recommendation

9. [Paragraph omitted from observer note].

10. [Paragraph omitted from observer note].

Question for the IFRIC

11. Does the IFRIC agree with the staff recommendation?

12. Does the IFRIC wish to refer the issue to the Board to ask the Board to clarify it (eg through the Board's Annual Improvements Process)?