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International
Accounting Standards
Board

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These notes are based on the staff papers prepared for the IASB. Paragraph numbers correspond to paragraph numbers used in the IASB papers. However, because these notes are less detailed, some paragraph numbers are not used.

INFORMATION FOR OBSERVERS

Board Meeting: **January 2009, London**

Project: **Annual Improvements**

Subject: **Scope of IFRIC 9 and Revised IFRS 3 (Agenda Paper 7)**

Issue

1. In June 2008, the Board tentatively decided to amend paragraph 5 of IFRS 2 *Share-based Payment* to affirm that common control transactions and the formation of a joint venture are not within the scope of IFRS 2. This agenda paper asks the Board whether it wishes to amend IFRIC 9 *Reassessment of Embedded Derivatives* in a manner similar to IFRS 2.

Issue: Should IFRIC 9 be amended to exclude from its scope contracts with embedded derivatives acquired in a combination of entities or businesses under common control or the formation of a joint venture?

Staff recommendation

2. The staff recommends that the Board amend paragraph 5 of IFRIC 9 to clarify that contracts with embedded derivatives recognised in a combination between entities or businesses under common control or the formation of a joint venture are excluded from the scope of that interpretation.

Staff analysis

3. The staff is aware of consequential amendments to IFRIC 9 as a result of the issuance of IFRS 3 *Business Combinations* (as revised in 2008). These consequential amendments were discovered during a review of the consequential amendments to IFRS 2 and were also noted by comment letters received on the exposure draft on IFRIC D15 *Reassessment of embedded derivatives* issued in March 2005.

4. Paragraph 6 of IFRIC 9 states, in part, '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.' IFRIC 9 prohibits the subsequent reassessment of the embedded derivative unless there is a change in the terms of the contract that significantly modifies the cash flows that otherwise would be required under the contract, in which case reassessment is required.

5. Paragraph 5 of IFRIC 9 states that the Interpretation 'does not address the acquisition of contracts with embedded derivatives in a business combination nor their possible reassessment at the date of acquisition'.

6. The former version of IFRS 3 defined a business combination, as 'The bringing together of separate entities or businesses into one reporting entity.' This **definition** then includes, among other things, business combinations in which separate entities or businesses are brought together to form a joint venture and business combinations involving entities or businesses under common control.

7. However, the former version of IFRS 3, paragraph 3 explicitly excludes:

    a. <u>business combinations in which separate entities or businesses are brought together to form a joint venture.</u>

    b. <u>business combinations involving entities or businesses under common control.</u>

    c. …..

8. Therefore, while the former IFRS 3 is currently effective (which has been the case since the issuance of IFRIC 9), transactions that result in the creation of joint ventures due to the bringing together of separate entities or businesses and business combinations involving entities or businesses under common control were defined to be a business combination and therefore scoped out of IFRIC 9. As such, no reassessment of embedded derivatives would be required (or possible) under IFRIC 9.

9. IFRS 3 (as revised in 2008), changes the definition of a business combination to 'A transaction or other event in which an acquirer obtains control of one or more businesses. Transactions sometimes referred to as "true mergers" or "mergers of equals" are also business combinations as that term is used in this IFRS.'

10. Under IFRS 3 (as revised in 2008), the creation of joint ventures due to the combination of two or more businesses or entities no longer meets the definition of a business combination. These transactions will therefore be subject to the provisions of IFRIC 9 and require reassessment of derivatives embedded in contracts included in the transaction.

11. Under IFRS 3 (as revised in 2008), a business combination involving entities under common control may continue to meet the definition of a business combination and would therefore continue to be excluded from the scope of IFRIC 9 depending upon the structure of the transaction and which level of the group of reporting entity is assessing the combination. However, in other circumstances the common control transaction would no longer meet the definition of a business combination (as defined in IFRS 3 (as revised in 2008)) and would therefore be subject to the provisions of IFRIC 9 requiring reassessment of derivatives embedded in contracts included in the transaction.

12. Paragraph 16c of IFRS 3 (as revised in 2008) specifically addresses the '[re]assessment of whether an embedded derivative should be separated from the host contract in accordance with IAS 39'. Given IFRS 3 (as revised in 2008) continues to exclude joint venture and common control transactions, the staff believes neither the IFRIC nor the Board intended either the creation of joint ventures or transactions under common control to be included within the scope of

IFRIC 9 which potentially requires reassessment of embedded derivatives for separation from their host contract. This is consistent with the decision taken by the Board at the June 2008 meetings on the scope of IFRS 2 related to business combination transactions.

13. Therefore, the staff recommends that the Board amend paragraph 5 of IFRIC 9 to clarify that the scope of IFRIC 9 excludes contracts with embedded derivatives acquired in a combination between entities under common control or in the formation of a joint venture.

Does the Board agree with the staff's recommendation in paragraph 13? If not, what does the Board recommend?

Annual improvement considerations

14. The staff suggests dealing with this issue as part of the Annual Improvement project and include the finalised amendment directly within the *Improvements to IFRSs* expected to be published in April 2009 along with the IFRS 2 amendment (which would exclude public exposure for this issue) and specify an effective date of 1 July 2009 (to align with the effective date of IFRS 3R). Specifically, the staff propose the following transition provisions:

    a. provide no relief for first-time adopters; and
    b. require prospective application of the proposed amendment with an effective date of 1 July 2009 (or early adoption consistent with the early adoption of IFRS 3 (as revised in 2008)).

    This approach is reasonable given it is a technical correction of the Board's historical and continuing conclusions regarding the exclusion from reassessment of contracts with embedded derivatives obtained through the formation of joint venture and common control transactions. It is a consequential amendment issue discovered by the staff during a review of the comment letters received on the exposure draft on *Improvements to IFRSs* issued in August 2008 and on the exposure draft of IFRIC D15 *Reassessment of embedded derivatives* issued in

March 2005. Additionally, it would eliminate the potential inconsistency between the scope exclusions in IFRS 2 as amended and IFRIC 9.

Does the Board agree with the staff recommendations for transition provisions as listed in paragraph 14a and 14b? If not, what does the Board recommend?

15. The Appendix to this agenda paper contains a draft amendment of IFRIC 9.

Does the Board agree with the draft amendment proposed in the Appendix to this paper?

Appendix

Drafting of proposed amendments to IFRIC 9 *Reassessment of Embedded Derivatives*

Paragraph 5 is amended (new text is underlined and deleted text is struck through) and paragraph 10 is added.

Scope

5 This interpretation does not ~~address~~ apply to the acquisition of contracts with embedded derivatives in:

a. a business combination;

b. a combination of entities or businesses under common control as described in paragraphs B1-B4 of IFRS 3 *Business Combinations* (as revised in 2008); or

c. the formation of a joint venture as defined in IAS 31 *Interests in Joint Ventures*

nor their possible reassessment at the date of acquisition.

The 'Effective date' paragraph (below) is added and will be numbered either 10 or 11 depending upon the finalization of the current exposure draft *Embedded Derivatives – Proposed amendments to IFRIC 9 and IAS 39* issued in December 2008.

Effective date

11 Paragraph 5 was amended by *Improvements to IFRSs* issued in [date]. An entity shall apply that amendment prospectively for annual periods beginning on or after 1 July 2009. If an entity applies IFRS 3 (revised 2008) for an earlier period, it shall disclose that fact and this amendment shall be applied for that earlier period.

Basis for Conclusions on Proposed Amendments to IFRIC 9 *Reassessment of Embedded Derivatives*

Paragraphs BC5A-BC5C are added.

Introduction

BC5A The Board observed that the changes to the definition of a business combination in the revisions to IFRS 3 *Business Combinations* (as revised in 2008) caused the accounting for the formation of a joint venture by the venturer to be within the scope of IFRIC 9 *Reassessment of Embedded*

Derivatives. Similarly, the Board noted that common control transactions might raise the same issue depending on which level of the group reporting entity is assessing the combination.

BC5B The Board observed that, during the development of the revised IFRS 3 (as revised in 2008), it did not discuss whether it intended IFRIC 9 to apply to these types of transactions. The Board did not intend to make this change to existing practice by scoping such transactions into IFRIC 9. Accordingly in *Improvements to IFRSs* issued in [date], the Board amends the scope of IFRIC 9 in paragraph 5 to clarify that IFRIC 9 does not apply to contracts with embedded derivatives acquired in a combination between entities or businesses under common control or the formation of a joint venture.