IASB’s Exposure Draft on Embedded Derivatives – Proposed amendments to IFRIC 9 and IAS 39

Dear Sir/Madam,

Mazars welcome the opportunity to comment on IASB’s Exposure Draft on Embedded Derivatives – Proposed amendments to IFRIC 9 and IAS 39.

We agree in principle with the proposals detailed in the exposure draft. Nevertheless we have concerns about the draft wording of paragraph 7A. We believe an entity should assess the separation from the host contract on the basis of the circumstances that existed either at initial recognition or at any later modification in the contractual terms of the hybrid instrument that modifies significantly the cash flows of the instrument. By doing so, an entity would account for a hybrid (combined) instrument reclassified out of the fair value through profit or loss category in the same way as if it had been classified out of that category at inception.

Our detailed answers are presented in the Appendix.

Should you wish to discuss further some of our comments, please contact Michel Barbet-Massin at +33 149 976 227.

Yours sincerely,

Michel Barbet-Massin
Head of Financial Reporting Technical Support
APPENDIX

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?

We agree with the proposed clarification.

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?

We agree in principle with the proposal.

We believe the wording proposed in the draft amendment may not address all situations. Indeed, we refer to BC7 (emphasis added):

BC7 The Board decided also to clarify that an assessment on reclassification should be made on the basis of the circumstances that existed when the entity first became a party to the contract. This date is consistent with one of the stated purposes of embedded derivative accounting (i.e. preventing circumvention of the recognition and measurement requirements for derivatives) and provides some degree of comparability. Furthermore, because the terms of the embedded features in the hybrid (combined) financial instrument have not changed, the Board did not see a reason for arriving at an answer on separation different from what would have been the case at initial recognition of the hybrid (combined) contract.

However, we are concerned that an entity may have modified the contractual terms of a hybrid instrument since it first became party to the contract. These modifications may not have led to a bifurcation since the instrument is still accounted for at fair value through profit or loss. According to the paragraph 7A as drafted in the exposure draft, one could understand that an entity would not have to consider these contractual modifications in its assessment as of the date of reclassification.

Therefore, we would propose that the wording of paragraph 7A be modified to take into account the above possibility (proposed modifications in bold and underlined):

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 either on the basis of the circumstances that existed when the entity first became a party to the contract or at any later modification in the contractual terms of the hybrid instrument that modifies significantly the cash flows of the instrument.
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?

We agree with the proposal.

Question 4 – Do you agree with the proposed effective date?

We agree with the proposal.

Question 5 – Are the transition requirements appropriate?

We believe the transition requirements are appropriate except that they do not address the issue of interim reports. Indeed, entities may have issued interim reports between July 1 and December 15 (i.e. application date as stated in the ED) in which reclassifications may have occurred without any reassessment of embedded derivatives. We foresee difficulties in future interim periods with regards to comparative figures. Hence we would welcome a statement clarifying whether the change from published interim reports should be accounted for as a change in accounting policy.