

To: IASB Improvement Project

Our date: 2008-10-31
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Comments on Improvements to IFRSs – IAS39 Financial Instruments: Recognition and Measurement – par 11A.

Question 1

Do you agree with the Board's proposal to amend the IFRS as described in the exposure draft? If no why, and what alternative do you propose?

IAS 39.11A

We do not support the change suggested to IAS 39.11A. We support that the fair value option in IAS 39.11A should apply both to financial and non-financial host contracts.

We believe that the Boards rationale for permitting the fair value option for financial contracts with embedded derivatives applies equally well to non-financial contracts with embedded derivatives.

The suggested changes would limit the scope of the fair value option in IAS 39.11A substantially. We are only aware that IAS 39.11A have been applied, or considered applied, to contracts that would have fallen within the scope of IAS 39 through paragraph 5 and 6 short for the own use exemption. Commodity markets and financial markets do have many similar characteristics; both in terms of liquidity and forward prices. Including commodity contracts in 11A would thus provide equally reliable values as for financial instruments.

We are not aware that any entities have applied the fair value option in IAS 39.11A to non-commodity contracts or in any way that might be considered an abuse. Further, we have never considered using IAS39 11A on leasing contracts, service contracts nor contracts for the purchase of PPE or other contracts that could be considered misuse of the paragraph. The application of IAS39.11A, before the proposed changes, was considered for contracts that would be scoped into IAS39, provided net settlement or "own use".

Hydro considered applying the fair value option on certain commodity contracts before IFRIC made the current interpretation of the existing IAS39.11A. However, as the first quarterly report with IFRS was issued after IFRIC made their interpretation, the fair value option was not applied to those contracts.

The IFRIC interpretation revoked the fair value option as applied by companies on commodity contracts containing embedded derivatives. As the investment community has limited knowledge of what embedded derivatives represent and as there is no consistent practice of how to calculate values of embedded derivatives, eliminating the possibility to fair value the entire contract creates communication challenges for companies. Communicating the fair value on an entire commodity contract will in some situations provide values which are perceived as more relevant by

management and the business community, especially if the fair value of the contract is positive while the embedded derivative component is negative, or opposite.

We consider the proposed changes to IAS39.11A as an unfortunate limitation and a step in the opposite direction of what is proposed as being IASBs long-term target of extended use of fair value where relevant.

We propose the following two possible solutions:

- Allow the fair value option for financial instruments and commodity contracts only (abuse of the fair value option on lease contracts, service contracts etc are thus prevented). Similar disclosure requirements that exist for the fair value option on financial instruments in IFRS 7 must be established for commodity contracts, or
- Make the own use exemption optional (as is currently the situation in US-GAAP). An option on the application of the own use exemption would be a more principle based solution for the entities that we currently see using, or considering using, the fair value option in IAS 39.11A. We do not support changing IAS 39.11A before a change has been made to the own use exemption.

In addition we would welcome more detailed rules for when embedded derivatives are to be valued as forward contracts on one commodity and when they are to be valued as swaps between commodities. Consistency in the valuation of embedded derivatives would improve the communication to and understanding of embedded derivatives in the investment community.

Yours faithfully,
for Norsk Hydro ASA

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