CL 104

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28th July 2004

Dear Sirs

Exposure draft "The Fair Value Option"

Please find attached our response to the exposure draft on amending the fair value option within IAS 39 "Financial Instruments: Recognition and Measurement".

As will be seen from our responses, we do not support the proposed amendments. We do not believe the new guidance will, in practice, provide the restrictions on use of the fair value option being sought and are concerned that new concepts, particularly that of "verifiability", are being introduced. Additionally, we remain unconvinced of the need for a restriction of the fair value option.

These responses represent the views of AstraZeneca PLC. Should you have any queries or wish to discuss these responses further, please do not hesitate to contact Bill Hicks (+44 1625 517294) or Andy Chard (+44 1625 517279).

Yours faithfully

Bill Hicks
Director, External Financial Reporting

Question 1
Do you agree with the proposals in this Exposure Draft? If not, why not? What changes do you propose and why?

Whilst we understand the Board's reasoning for introducing the amendment, we do not agree with the proposals, for two principal reasons:

- Firstly, we do not believe that the proposals will be successful in limiting the use of the fair value option for, in particular, financial liabilities. This is because the existence of an embedded derivative (however arbitrary, artificial or valueless) within a financial liability will allow an entity to employ the fair value option as amended. Similarly, the provisions of paragraph 50 means that, once a financial liability is designated at fair value through profit or loss it cannot be redesignated – this would allow, for example, an entity to designate a financial liability at fair value through profit or loss by taking out an interest rate swap and then dispose of the swap instrument, whilst still leaving the liability designated at fair value through profit or loss.
- Secondly, like other commentators, we are concerned about the introduction of the concept of verifiabilitiy, a concept which appears not to have been developed adequately. The result is that a higher test exists where an entity is <u>permitted</u> to fair value a financial instrument compared to where the entity is <u>required</u> to fair value. We are also concerned that the parameters of "substantially offset" test have not been defined although we believe that the Board would look to the hedging 80%-125% example.

Lastly, we believe that the amendments will limit the ability of certain entities to use the concessions in IAS 28 "Investments in Associates" and IAS 31 "Investments in Joint Ventures" which we do not believe was the Board's intention.

Question 2
Are you aware of any financial instruments to which entities are applying, or are intending to apply, the fair value option that would not be eligible for the option if it were revised as set out in this Exposure Draft? If so:

(a) please give details of the instrument(s) and why it (they) would not be eligible.

(b) is the fair value of the instrument(s) verifiable (see paragraph 48B) and if not, why not?

(c) how would applying the fair value option to the instrument(s) simplify the practical application of IAS 39?

We are not aware of any actual examples where the fair value option would not continue to be available. However, we can envisage circumstances, particularly in the case of financial liabilities with interest rate swaps, where the amendments would make it difficult or impractical to apply the option as amended.

Question 3
Do the proposals contained in this Exposure Draft appropriately limit the use of the fair value option so as to address adequately the concerns set out in paragraph BC9? If not, how would you further limit the use of the option and why?

Please see our answer to Question 1. We believe that the existing disclosure requirements in IAS 32 of the amount of the change in the fair value of a financial liability that is not attributable to changes in the benchmark interest rate were sufficient, although increasing the prominence of such disclosures may improve the guidance.

Question 4
Paragraph 9(b)(i) proposes that the fair value option could be used for a financial asset or financial liability that contains one or more embedded derivatives, whether or not paragraph 11 of IAS 39 requires the embedded derivative to be separated. The Board proposes this category for the reasons set out in paragraphs BC6(a) and BC16-BC18 of the Basis for Conclusions on this Exposure Draft. However, the Board recognises that a substantial number of financial assets and financial liabilities contain embedded

derivatives and, accordingly, a substantial number of financial assets and financial liabilities would qualify for the fair value option under this proposal.

Is the proposal in paragraph 9(b)(i) appropriate? If not, should this category be limited to a financial asset or financial liability containing one or more embedded derivatives that paragraph 11 of IAS 39 requires to be separated?

Please see our response to Question 1.

Question 5

Paragraph 103A proposes that an entity that adopts early the December 2003 version of IAS 39 may change the financial assets and financial liabilities designated as at fair value through profit or loss from the beginning of the first period for which it adopts the amendments in this Exposure Draft. It also proposes that in the case of a financial asset or financial liability that was previously designated as at fair value through profit or loss but is no longer so designated:

(a) if the financial asset or financial liability is subsequently measured at cost or amortised cost, its fair value at the beginning of the period for which it ceases to be designated as at fair value through profit or loss is deemed to be its cost or amortised cost.

(b) if the financial asset is subsequently classified as available for sale, any amounts previously recognised in profit or loss shall not be reclassified into the separate component of equity in which gains and losses on available-for-sale assets are recognised.

However, in the case of a financial asset or financial liability that was not previously designated as at fair value through profit or loss, the entity shall restate the financial asset or financial liability using the new designation in the comparative financial statements.

Finally, this paragraph proposes that the entity shall disclose:

(a) for financial assets and financial liabilities newly designated as at fair value through profit or loss, their fair value and the classification and carrying amount in the previous financial statements.

(b) for financial assets and financial liabilities no longer designated as at fair value through profit or loss, their fair value and the classification and carrying amount in the current financial statements.

Are these proposed transitional requirements appropriate? If not, what changes do you propose and why? Specifically, should all changes to the measurement basis of a financial asset or financial liability that result from adopting the amendments proposed in this Exposure Draft be applied retrospectively by restating the comparative financial statements?

Subject to our overall objections to the proposals, we believe the transitional arrangements are appropriate.

Question 6

Do you have any other comments on the proposals?

We do not have any further comments.