

Tricia O'Malley
IFRIC Co-ordinator
International Accounting Standards Board
30 Cannon Street
London
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28 June 2007

Dear Ms O'Malley

IFRIC Tentative Agenda Decision: IAS 39 – Scope of paragraph 11A

We are responding to your invitation to comment on the above Tentative Agenda Decision, published in the May edition of IFRIC Update on behalf of PricewaterhouseCoopers.

Following consultation with members of the PricewaterhouseCoopers network of firms, this response summarises the views of member firms who commented on the agenda decision. 'PricewaterhouseCoopers' refers to the network of member firms of PricewaterhouseCoopers International Limited, each of which is a separate and independent legal entity.

We note that the IFRIC was asked to consider whether the fair value option available in paragraph 11A of IAS 39 can be applied to all contractual arrangements with one or more embedded derivatives, including contractual arrangements that contain host contracts outside the scope of IAS 39. We disagree with the IFRIC's tentative conclusion that the fair value option available in paragraph 11A of IAS 39 is not applicable to contractual arrangements in which the host contract is outside the scope of IAS 39.

We believe that the fair value option should apply to both financial and non-financial host contracts with embedded derivatives. Limiting the application of the fair value option to only financial host contracts is inconsistent with both the wording of IAS 39 and the Board's rationale for permitting the fair value option to be used for contracts with embedded derivatives, as described further below.

An embedded derivative causes some or all of the cash flows that otherwise would be required by the contract to be modified according to an underlying variable. The modification in cash flows of the host contract and the consequent requirement to separate non-closely related embedded derivatives is not limited to financial instruments. Rather IAS 39 makes it clear that these requirements extend to non-financial host contracts. For example, the Standard refers to non-financial host contracts such as lease contracts (AG33(f)), insurance contracts (AG 33(h)), and contracts for the purchase or sale of a non-financial item where the price is denominated in a foreign currency (AG33(d)). Therefore, the application of the embedded derivatives guidance has always been broader than host contracts within the scope of IAS 39. (ie embedded derivatives are in the scope of IAS 39 even if their host contract is not).

We also look to the wording of the relevant paragraphs. Paragraph 11 establishes that the host contract can be either a financial or a non-financial instrument. Similarly, paragraph 12 requires all types of hybrid contracts to be measured at fair value in cases where an embedded derivative is required to be separated but cannot be reliably measured. This paragraph also applies to both hybrid contracts where the host is a financial instrument and those where the host is not a financial instrument. Paragraph 11A, that is located between these two paragraphs permits use of the fair value option for contracts with embedded derivatives (provided the two conditions in paragraph 11A are met). We therefore interpret the word 'contract' in paragraph 11A in the same way as it is used in paragraphs 11 and 12 – ie to include both financial and non-financial host contracts. In our view, without an explicit exclusion, all types of contract should be included. It seems inconsistent to apply one interpretation of what can be a host contract to paragraphs 11 and 12, and a different one to their neighbour, paragraph 11A.

Further support for our view lies in the Basis for Conclusions to IAS 39 that sets out the reason why the Board permitted the fair option to be used for contracts with embedded derivatives. As outlined in BC 77A, the objective was to reduce the cost and complexity of complying with IAS 39. We believe that this objective applies equally to financial and non-financial host contracts and hence that the use of the fair value option is equally justified for both.

As a result of the above, we believe that there is scope for an alternative interpretation of the literature and therefore that there may be significant diversity in practice. Consequently we do not believe that this matter can be adequately addressed by way of an IFRIC agenda decision.

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If you have any questions in relation to this letter please do not hesitate to contact Richard Keys, PwC Global Chief Accountant (+44 20 7802 4555), or Pauline Wallace (+44 20 7804 1283).

Yours sincerely

PricewaterhouseCoopers LLP