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Robert Garnett, Chairman
International Financial Reporting Interpretations Committee
30 Cannon Street
London EC4M 6XH

Email: ifric@iasb.org

Dear Bob,

IAS 39 *Financial Instruments: Recognition and Measurement* – Written Options in Retail Energy Contracts

Deloitte Touche Tohmatsu is pleased to respond to IFRIC's publication in the January 2007 *IFRIC Update* of the tentative decision not to take onto the IFRIC agenda a request for an interpretation on what is a 'written option' with respect to IAS 39.7 and specifically with reference to energy supply contracts to retail customers.

Whilst we support the IFRIC's decision not to take this item onto the agenda and the contention that in many instances such contracts will not be within the scope of IAS 39 we do have concerns over the content of the tentative IFRIC rejection. We make the following comments based on a reading of the tentative rejection wording in combination with the publicly available Observer Notes for the January 2007 IFRIC meeting (Agenda Paper 14(iv)).

Firstly, we disagree with the view expressed in the *Observer Notes* that the retail energy contracts with volumetric flexibility under consideration are unambiguously always written options in accordance with IAS 39. We believe there are strong arguments that can be put forward that such contracts are not written options based on the inability of the holder of such options to exercise them for economic gain. Therefore, whilst we share the conclusion reached in the tentative rejection wording that such contracts are outside the scope of IAS 39 we reach this conclusion for different reasons to those expressed in the Observer Notes.

Secondly, the tentative rejection wording could introduce confusion over the treatment of other energy contracts including non-retail contracts. The rejection wording states retail energy contracts would not meet the "net settlement criteria in paragraph 5 and 6" but is not specific as to which part of the criteria is the key determinant in reaching this conclusion. We note that one of the ways in which a contract could be 'net settled' is for the non-financial item that is the subject of the contract to be readily convertible to cash under IAS 39.6(d). The tentative IFRIC rejection wording therefore *implicitly* states that at least within the context of energy supply

contracts to retail customers the non-financial item (in this case electricity) will often not be readily convertible to cash. If IFRIC believes this is the case then it is worth stating. Without clarity on this the rejection will introduce uncertainty as to whether this means that a non-financial item such as electricity is readily convertible to cash in *all* contracts generally.

Thirdly, we note that IAS 39.BC221(a) refers to the elimination of selected differences from US GAAP which was introduced as part of the improvement project. The improvements project introduced the ‘written option’ and ‘readily convertible into cash’ guidance in IAS 39.6. That paragraph states:

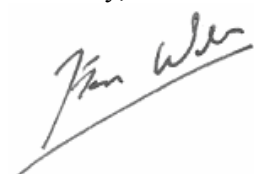
“The Board decided that a contract to buy or sell a non-financial item is a derivative within the scope of IAS 39 if the non-financial item that is the subject of the contract is readily convertible to cash and the contract is not a ‘normal’ purchase or sale. This requirement is comparable to the definition of a derivative in SFAS 133, which also includes contracts for which the underlying is readily convertible to cash, and to the scope exclusion in SFAS 133 for ‘normal’ purchases and sales.”

SFAS 133.58(b) includes detailed requirements in how to apply the ‘normal purchases and sales’ exception (as stated in the quote above) for electricity purchase contracts. The above paragraph states the requirements are comparable. However, we are concerned that even though the accounting for certain retail electricity contracts under US GAAP and IFRS following the rejection wording may be consistent, ie they are not in the scope of SFAS 133 and IAS 39 respectively, the justification for this conclusion will differ and run contrary to IAS 39.BC221(a). Clarity of the justification for the conclusion reached in the rejection notice will assist users in understanding how to apply IFRS and how it compares to US GAAP in light of IAS 39.BC221(a).

Our final concern is not specific to just this rejection wording but applies more broadly. We are concerned that the rejection wording focuses too much on an underlying scenario and fact pattern, and not enough on the interpretative accounting issue. In this rejection, there is a significant focus on the example of retail energy contracts, even though the accounting issue of what is a ‘written option’ with respect to contracts over non-financial is broad. Retail energy contracts are just one example. Volumetric optionality beyond the retail sector and optionality over price are equally worthy of discussion. One of the consequences of not adequately identifying the reason why retail energy contracts are outside the scope of IAS 39 is that practitioners will attempt to infer your reasoning from your rejection wording and apply that inference more broadly. Without clarity there is a risk that different practitioners will infer different reasoning and divergence in practice will increase.

If you have any questions concerning our comments, please contact Ken Wild in London at +44 (0) 207 007 0907.

Sincerely,



Ken Wild
Global IFRS Leader
cc: Allan Cook, IFRIC Coordinator