

**CL 137P**

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14<sup>th</sup> October 2002

Dear Sirs

**Financial Reporting Exposure Draft No. 30**

We are writing in response to the issuance of Financial Reporting Exposure Drafts No. 30. We set out in the accompanying appendix our comments on the proposed Financial Reporting Standards, together with the responses we have made to the International Accounting Standards Board on the corresponding proposed amendments to IAS 32 ‘Financial Instruments: Disclosure and Presentation’ and IAS 39 ‘Financial Instruments: Recognition and Measurement’. However, our responses should be read in the context of the general principle set out in the next paragraph.

The proposed standard is based substantially on the proposed revised IAS 32 and 39 and is large and complex. However, it is different in a number of significant ways from these corresponding IASs. For listed companies, the proposed standard would be introduced in 2004, for one year only for calendar companies, before replacement by IAS 32 and 39 in 2005 and restatement of the 2004 corresponding year. This imposes an artificial, costly and time-consuming timetable for transition to International Accounting Standards.

This letter sets out the responses 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 Richard Smith (+44 1625 517297).

Yours faithfully

Bill Hicks  
**Chief Statutory Accountant**

## Questions for respondents

*Treating IASs 32 and 39 as a package (Appendix III, paragraph 15) The ASB has concluded that it is best to view the requirements in IASs 32 and 39 as a single package of requirements that should, as far as is practicable, be implemented in the UK at a single point in time. Do you share this view?*

We agree that IAS 32 and 39 should be introduced as a single package of requirements but believe that this should be effected through the 2005 introduction of International Accounting Standards.

*Implementation in 2004 (Appendix III, paragraphs 17-20) Notwithstanding the general approach referred to in (i) above, the ASB is proposing to implement, at a single point in time, some parts of the standards in mandatory form, some in non-mandatory form and some not at all for the time being. At the same time, it is proposing to withdraw FRSs 4 and 13 (and related UITF Abstracts) and keep in place most parts of FRS 5. Do you believe that, in the circumstances, this represents the best possible approach of implementing in the UK the international requirements in this area?*

We do not believe this is the best approach to introducing the requirements of IAS 32 and 39. In addition to comments above, we are concerned that the proposed standard should have a mix of mandatory, non-mandatory and prohibited provisions on initial application in 2004.

*Recognition and derecognition (Appendix III, paragraphs 23-29) The FRED proposes that the proposed new IAS 39 approach to recognition and derecognition should not be implemented in the UK at the present time. Instead, when the direction of international convergence on this subject becomes clearer, a further consultation document will be issued. Do you agree with this approach?*

We do not agree with this approach. Although we accept that the IASB approach on derecognition is new and untested we believe that it is likely to be introduced in some form in 2005. Accordingly, the provisions will apply retrospectively to cover, for most entities, the period that the proposed standard in FRED 30.

*Measurement (Appendix III, paragraphs 30-49) The ASB is proposing that, prior to 2005, companies should be required to adopt IAS 39's measurement requirements only if they choose to adopt the fair value accounting rules that will be set out in companies legislation. Entities that do not choose to adopt those rules will not initially be required by UK standards to adopt the measurement requirements at all.*

- (a) Do you agree with this approach?

We do not agree with the proposed approach. Firstly, for the same reasons outlined in other responses, we believe that this approach will be that required in the final form of IAS 39 that listed companies will be required to adopt in 2005. Secondly, recycling appears to have strong international support (for example, in the US).

- (b) *Do you agree that the recycling requirements of IAS 39 should not be implemented in the UK pending completion of the project on reporting financial performance and do you agree with the alternative treatment proposed in the FRED? (Appendix III, paragraphs 50-52)*

No, for the reasons set out previously.

*Hedge accounting The ASB is proposing a similar approach to IAS 39's hedge accounting requirements as to its measurement requirements. (Appendix III paragraphs 57-63, 69 and 70)*

- (a) *Do you agree with this approach?*

No, for the reasons set out in previous answers.

- (b) *Do you agree that the approach being proposed in place of recycling? (Appendix III paragraphs 64-68)*

No, for the reasons set out in previous answers.

*Unlisted entities and individual financial statements*

- (a) *The FRED proposes that, prior to 2005, entities should be required to comply with IAS 39's measurement and hedge accounting provisions in certain circumstances only. That will change in 2005 for the consolidated financial statements of listed entities but, the FRED suggests, not for other entities or other types of financial statement. Thus, from 2005 listed entities that do not prepare consolidated financial statements and unlisted entities will not be required to adopt IAS 39's measurement and hedge accounting provisions unless they choose to adopt the fair value accounting rules set out in the Companies Act 1985. Similarly, listed entities that prepare consolidated financial statements will not be required to adopt IAS 39's measurement and hedge accounting provisions in their individual financial statements unless they adopt the fair value accounting rules in those financial statements. Do you agree with this approach?*

We do not agree with this approach as it will lead to several layers of GAAP being applied by entities in the UK.

- (b) *FRS 13's disclosure requirements apply only to entities, other than insurance entities, that are listed or have publicly-traded securities and all banks. The ASB is proposing to revise the disclosure requirements on 1 January 2004 and to apply those new requirements to all listed entities, all other entities that have publicly-traded securities and all banks (in other words, the exemption for listed insurance entities will be removed, but otherwise the scope will be unchanged). Do you agree with this approach or do you believe that, from 2004, the requirements should apply to some other entities (for example, unlisted insurance companies) or, alternatively, to a narrower range of entities?*

We refer to our previous answers. We believe that introduction of the proposed standard is not helpful with the impending introduction of International Accounting Standards in 2005.

- (c) *FRS 13's disclosure requirements apply both to consolidated financial statements and to individual financial statements, except that they do not need to be applied in the individual financial statements of entities that are preparing FRS 13-compliant consolidated financial statements. The FRED proposes to retain a similar exemption. Do you agree with this approach?*

We agree with the exemption should the standard be introduced.

## **Amendments to IAS 32, Financial Instruments: Disclosure and Presentation, and IAS 39, Financial Instruments: Recognition and Measurement**

### ***Question 1 - Probabilities of different manners of settlement (paragraphs 19, 22, and 22A)***

*Do you agree that the classification of a financial instrument as a liability or as equity in accordance with the substance of the contractual arrangements should be made without regard to probabilities of different manners of settlement? The proposed amendments eliminate the notion in paragraph 22 that an instrument that the issuer is economically compelled to redeem because of a contractually accelerating dividend should be classified as a financial liability. In addition, the proposed amendments require a financial instrument that the issuer could be required to settle by delivering cash or other financial assets, depending on the occurrence or non- occurrence of uncertain future events or on the outcome of uncertain circumstances that are beyond the control of both the issuer and the holder of the instrument, to be classified as a financial liability, irrespective of the probability of those events or circumstances occurring (paragraph 22A).*

We agree that financial instruments should be classified as liabilities or equity according to their substance, but believe the use of the phrase “without regard to the probabilities of different manners of settlement” is confusing and contradicts the overall approach.

*Question 2— - Separation of liability and equity elements (paragraphs 28 and 29) Do you agree that the Options in IAS 32 for an issuer to measure the liability element of a compound financial instrument initially either as a residual amount after separating the equity element or based on a relative-fair-value method should be eliminated and, instead, any asset and liability elements should be separated and measured first and then the residual assigned to the equity element?*

We agree with the removal of the option for measuring compound financial instruments. We do note that we believe the current approach for measuring compound financial instruments can result in a gain in the income statement if the instrument is settled in cash appears anomalous, although we understand the principles behind this.

### ***Question 3 - Classification of derivatives that relate to an entity's own shares (paragraphs 29C-29G)***

*Do you agree with the guidance proposed about the classification of derivatives that relate to an entity 's own shares?*

We agree with the guidance proposed in paragraphs 29C to 29G. However, we do question whether the provision in paragraph 29 that changes in the fair value of the derivative are not recognized may prove inconsistent with any guidance on share-based payments.

### ***Question 4— Consolidation of the text in IAS 32 and IAS 39 into one comprehensive Standard***

*Do you believe it would be useful to integrate the text in IA S3 2 and L4S39 into one comprehensive Standard on the accounting for financial instruments? (Although the*

*Board is not proposing such a change in this Exposure Draft it may consider this possibility in finalising the revised Standards)*

We believe that combining the two standards as one would be beneficial, although we recognize that the resulting standard would be voluminous.

**Question 1 Scope: loan commitments (paragraph 1 (i))**

*Do you agree that a loan commitment that cannot be settled net and the entity does not designate as held for trading should be excluded from the scope of IAS 39?*

We agree with the proposed exclusion. This addresses the concern we have with the proposals in the JWG discussion paper which would result in an entity whose credit risk had been downgraded reporting a gain in the income statement. We also agree with the exception to the exclusion that would allow certain liabilities to be designated as held for trading but would recommend guidance on a similar basis to held-to-maturity instruments which would provide penalties for abuse of this exemption (for example, evidence that such liabilities are not being settled in the near term).

**Question 2-- Derecognition: continuing involvement approach (paragraphs 35-57)**

*Do you agree that the proposed continuing involvement approach should be established as the principle for derecognition of financial assets under IAS 39? If not what approach would you propose?*

We support, in principle, the proposed approach. However, we are concerned that the examples in Appendix B may be in conflict with other IASs; in particular the first example seems to be in conflict with IAS 37 on contingent liabilities.

**Question 3— Derecognition: pass- through arrangements (paragraph 41)**

*Do you agree that assets transferred under pass- through arrangements where the cash flows are passed through from one entity to another (such as from a special purpose entity to an investor) should qualify for derecognition based on the conditions set out in paragraph 41 of the Exposure Draft?*

We agree that the conditions set out in paragraph 41 qualify an asset for derecognition.

**Question 4— Measurement: fair value designation (paragraph 10)**

*Do you agree that an entity should be permitted to designate any financial instrument irrevocably at initial recognition as an instrument that is measured at fair value with changes in fair value recognised in profit or loss?*

We agree with the proposed approach and we believe it should be irrevocable. Although an entity may be able to by-pass such a condition by selling and repurchasing the asset, we agree with the Board that such a requirement will “impose a discipline on the approach”.

**Question 5-- Fair value measurement considerations (paragraphs 95- 100D)**

*Do you agree with the requirements about how to determine fair values that have been included in paragraphs 95-- 100D of the Exposure Draft? Additional guidance is included in paragraphs A32-- A42 of Appendix A. Do you have any suggestions for additional requirements or guidance?*

We welcome the extended guidance.

**Question 6-- Collective evaluation of impairment (paragraphs 112 and 113A- 113D)**

*Do you agree that a loan asset or other financial asset measured at amortised cost that has been individually assessed for impairment and found not to be individually impaired should be included in a group of assets with similar credit risk characteristics that are collectively evaluated for impairment? Do you agree with the methodology for measuring such impairment in paragraphs 113A- 113D?*

We do not agree with the proposed approach. Although it appears to have the benefit of practicality, we believe that actual application would require effective individual asset impairment testing.

**Question 7-- Impairment of investments in available-for- sale financial assets (paragraphs 117— 119)**

*Do you agree that impairment losses for investments in debt and equity instruments that are classified as available for sale should not be reversed?*

No, we do not agree with the proposed guidance. It appears to be inconsistent with other guidance in the impairment area, for example in IAS 2 “Inventories” and IAS 16 “Property, Plant and Equipment”. In particular, our concerns expressed in our reply on the proposed improvements to IAS 2 are alleviated here by the possibility of an active market underpinning the fair value.

**Question 8— Hedges of firm commitments (paragraphs 137 and 140)**

*Do you agree that a hedge of an unrecognized firm commitment (a fair value exposure) should be accounted for as a fair value hedge instead of a cash flow hedge as it is at present?*

No, we do not agree with the proposal. We believe that the accounting of the hedge instrument should follow the accounting of the hedged item. The proposal appears to be in conflict with the approach discussed in paragraph 160.

**Question 9— ‘Basis adjustments’ (paragraph 160)**

*Do you agree that when a hedged forecast transaction results in an asset or liability, the cumulative gain or loss that had previously been recognized directly in equity should remain in equity and be released from equity consistently with the reporting of gains or losses on the hedged asset or liability?*

We do not agree, on two grounds. Firstly, the proposed approach does not reflect the substance of the transaction, whereby an asset should be recorded at the price an entity pays for it. Secondly, we believe the proposed approach would add unnecessary complexity to financial record keeping and would not benefit clarity in the financial statements.



***Question 10—Prior derecognition transactions (paragraph 171B)***

*Do you agree that a financial asset that was derecognised under the previous derecognition requirements in IAS 39 should be recognised as a financial asset on transition to the revised Standard if the asset would not have been derecognised under the revised derecognition requirements (ie that prior derecognition transactions should not be grandfathered)? Alternatively, should prior derecognition transactions be grandfathered and disclosure be required of the balances that would have been recognised had the new requirements been applied?*

We agree with the proposals.