Deloitte.

Deloitte Touche Tohmatsu
Hill House
1 Little New Street
London EC4A 3TR
United Kingdom

Tel: National +44 20 7936 3000
Direct Telephone: +44 20 7007 0907
Direct Fax: +44 20 7007 0158
www.deloitte.com
www.iasplus.com

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Sir David Tweedie
Chairman
International Accounting Standards Board
30 Cannon Street
London EC4M 6XH

commentletters@iasb.org

Dear Sir David

IFRIC Draft Interpretation D15 *Reassessment of Embedded Derivatives*

Deloitte Touche Tohmatsu is pleased to comment on the International Financial Reporting Interpretations Committee's (IFRIC) Draft Interpretation 15 – *Reassessment of Embedded Derivatives* (referred to as D15 or the draft Interpretation).

We believe the draft Interpretation is an appropriate and practical interpretation of IAS 39 *Financial Instruments: Recognition and Measurement* (IAS 39) and support its issuance. However, we do have two substantive comments. Firstly, we strongly encourage the IFRIC to clarify whether the assessment of hybrid instruments is required for an acquirer at the time of a business combination. Divergent views are already in existence on this issue, and D15 presents an opportunity to clarify this matter, similar to the issue set out in paragraph 3(b) of D15. Secondly, the IFRIC should clarify that the scope of D15 is limited solely to the 'closely related' decision, and not the other requirements in paragraph 11 of IAS 39.

Assessment on the date of acquisition upon a business combination

We believe that an acquirer in a business combination is required to make an assessment of the acquired identifiable assets and liabilities at the acquisition date in order to determine whether any embedded derivatives should be separated based on conditions existing at that date. Consistent with D15, the acquiree is required to have made such an assessment at the time of becoming a party to the contracts, which may result in a different conclusion to that reached by the acquirer for reasons set out in BC3 to BC5 of D15. Proponents of this view believe the acquirer's assessment is required at the acquisition date of the business combination as that is when the acquirer, and hence the group, become a party to the hybrid instrument. Consequently, the consolidated financial statements may differ from those of the acquiree as regards separation of embedded derivatives.

We believe it should not be possible for an entity to avoid considering whether an embedded derivative is closely related simply because the entity becomes party to the contractual provisions of a hybrid instrument via a business combination as opposed to becoming a party to the arrangement directly without the business combination. We therefore support the view that an entity should consider the closely related decision at the acquisition date of a business combination.

Others believe that an acquirer should not make an assessment of the acquired identifiable assets and liabilities at the acquisition date with a view to establishing whether embedded derivatives should be separated or not, accepting that the acquiree's assessment at the time of becoming a party to the contract is the only assessment required under IAS 39 and is not superseded by the requirements to identify the acquiree's assets and liabilities in accordance with IFRS 3 *Business Combinations*.

Limitation of guidance to the 'closely related' criterion

D15 can be read as applying to IAS 39 in a wider sense than intended. We believe the issue dealt with by D15 to be primarily that of assessing hybrid instruments for embedded derivatives on the basis of whether they are 'closely related' as required by paragraph 11(a) of IAS 39. Some may read D15 as wider guidance due to the references in paragraph 2 of D15 (read together with paragraph 3), to paragraph 11(b) and (c) of IAS 39. Such a wide reading may lead preparers to believe that contracts entered into and held for the purpose of the receipt or delivery of a non-financial item in accordance with that entity's expected purchase, sale or usage requirements, should not be continuously reassessed to determine whether despite initial expectations, the net settlement characteristics are fulfilled and therefore such contracts are within the scope of IAS 39 and potentially meet the definition of a derivative. We acknowledge that such a reading would be contradictory to paragraph 6 of IAS 39, however, we believe it would be worthwhile for IFRIC to clarify this issue beyond any doubt, by appropriately narrowing the scope of the draft Interpretation to the issue of 'closely related'.

Other comments

We are concerned that the drafting of paragraph 4 of D15 only refers to "a change in the terms of the contract". As drafted, D15 can be read as requiring reassessment where changes to contracts are insignificant. In order to avoid this erroneous interpretation of D15, and therefore IAS 39, we suggest that paragraph 4 be redrafted to refer to "a substantive change" or other appropriate measure. In addition, we believe paragraph 5 of D15 would require editing along the following lines: "…on the basis of the conditions that existed <u>at the later of</u> when it first became a party to the contract<u> or the latest substantive change to the terms of the contract</u>".

As regards transition, we believe IFRIC may wish to consider an exception to the retrospective application requirement that would allow a contract that had an embedded derivative at the time of inception, but that embedded derivative has ceased to exist at the time of adopting D15, not to restate comparative information. Consistent with the pragmatic approach taken by the IFRIC in developing D15, such an exception would save preparers from the significant cost and effort required to restate financial information for arrangements that no longer exist, for what can be viewed as little benefit to users of financial statements going forward.

If you have any questions concerning our comments, please contact the undersigned in London at (020) 7007 0907.

Sincerely,

Ken Wild
Global IFRS Leader