LEMBAGA PIAWAIAN PERAKAUNAN MALAYSIA
MALAYSIAN ACCOUNTING STANDARDS BOARD

23 May 2007

Mr. Jon Nelson
International Accounting Standards Board (IASB)
30 Cannon Street
LONDON EC4M 6XH
UNITED KINGDOM

Dear Mr. Nelson,

IASB Discussion Paper: Fair Value Measurements

The Malaysian Accounting Standards Board appreciates the opportunity to give views on the above discussion paper and wishes to express our intention to participate in your round-table meeting.

Our review has been guided by the practical considerations of the needs of users and preparers of general purpose financial statements particularly from developing economies perspective, an aspect you specifically sought views on.

We do not believe a general guidance on the application of fair value measurements is appropriate for all types of assets and liabilities. What is needed is specific guidance on different types of assets and liabilities due to different nature of assets and liabilities. Clearly the valuation for share options and biological assets will require different guidance given the fact that their attributes are different. Biological assets do not share common bases for valuation as those for share options.

In addition, the proposals put forth are difficult to apply especially in developing countries where there is unlikely to be active market for transactions other than quoted financial instruments. These transactions tend to suffer from lack of readily available and reliable market information to enable the concepts proposed in the paper to be applied meaningfully.

The circumstances could be more challenging in developing countries where depth and degree of maturity and liquidity of the markets not only inhibit information that can reflect fairly market transactions but could lead to an unnecessary search for a hypothetical market which is unrealistic, and would undermine the fair value information.

Suites 5.01-5.03, Fifth Floor, 338 Jalan Tuanku Abdul Rahman, 50100 Kuala Lumpur, Malaysia.
Tel : (603) - 2715 9199 Fax : (603) - 2715 9212 E-mail : masb@masb.org.my

The assumptions used in arriving at a measure of fair value could raise several valuation issues as well. For example, the assumptions in level 3 hierarchy can vary vastly between entities, and when applied, is unlikely to improve consistency in the measurement of fair value and raises doubt as to the relevance, reliability and comparability of the fair value information.

The above are but general comments we have on the discussion paper. Comments on specific issues raised in the paper are set out in the accompanying pages. If you need clarifications on the responses, please feel free to contact Dr Nordin Mohd Zain, the Executive Director at +603 2715 9199 or e-mail at nordin@masb.org.my.

Yours sincerely,

Dato' Zainal Abidin Putih
Chairman

Issue 1 – SFAS 157 and fair value measurement guidance in current IFRS

Question 1

In your view, would a single source of guidance for all fair value measurements in IFRSs both reduce complexity and improve consistency in measuring fair value? Why or why not?

Response

Although we agree to a single source of guidance, we believe a general guidance on the application of fair value measurement basis to all types of assets and liabilities is inappropriate.

We believe how fair value is reflected in IFRS needs to be considered standard by standard basis, giving due peculiarity to the item in question.

Question 2

Is there fair value measurement guidance in IFRSs that you believe is preferable to the provisions of SFAS 157? If so, please explain.

Response

No.

Issue 2 – Differences between the definitions of fair value in SFAS 157 and in IFRSs

Issue 2A – Exit price measurement objective

Question 3

Do you agree that fair value should be defined as an exit price from the perspective of a market participant that holds the asset or owes the liability? Why or why not?

Response

As a pragmatic approach, we have no objection that fair value should be defined as an exit price from the perspective of a market participant.

Adding the concept "a market participant" (as per the definition in SFAS 157) and apply it in conjunction with "exit price" in the context of SFAS 157 would, in our view provide a measurement that placed virtually no emphasis on "entity specific" element, leading to a value that is as fair as one can get in practice.

While the proposal would lead to the best measure of fair value in concept, we are concerned that applying this concept in practice may not be easy especially in a lesser developed market where it is difficult to attain the following attributes of "a market participant":

- **Principal market**
- **Independent of the reporting entity**
- **Knowledgeable**
- **Able to transact**
- **Willing to transact**

Such a concept would work well in a developed market, but in a lesser developed market where level 3 input may be the norm, we cannot see how the notion of "a market participant" can hold true as inevitably level 3 would place higher emphasis on "entity specific" element into the fair valuation consideration.

Question 4

Do you believe an entry price also reflects current market-based expectations of flows of economic benefit into or out of the entity? Why or why not?

Additionally, do you agree with the view that, excluding transaction costs, entry and exit prices will differ only when they occur in different markets? Please provide a basis for your views.

Response

On the premise that we accepted the definition of fair value and market participant in this Standard, excluding transaction costs entry price and exit price will differ only when they occur in different markets. Although this may be conceptually sound, such conclusion only hold true for certain types of assets, such as financial assets and other readily marketable or trading assets where there is an active and liquid market.

However it is not necessarily true that for some types of assets the entry price is the same as exit price even in the same market despite ignoring

transaction costs. Due consideration therefore should be given for the different types of assets and liabilities.

Question 5

Would it be advisable to eliminate the term 'fair value' and replace it with terms, such as 'current exit price' or 'current entry price' that more closely reflect the measurement objective for each situation? Please provide a basis for your views.

Response

No, the term 'fair value' should not be replaced with terms such as 'current exit price' or current entry' price'. Instead guidance should be provided for the different fair value measurement basis for each type of assets and liabilities under consideration – see earlier responses.

Question 6

Does the exit price measurement objective in SFAS 157 differ from fair value measurements in IFRSs as applied in practice? If so, which fair value measurements in IFRSs differ from the measurement objective in SFAS 157? In those circumstances, is the measurement objective as applied in practice an entry price? If not, what is the measurement objective applied in practice? Please provide a basis for your views.

Response

No, in most cases the exit price measurement objective in SFAS 157 does not differ from fair value measurement in IFRSs except for business combination where the fair value on initial recognition may be the entry price, as has been normally applied in practice.

Issue 2B – Market participant view

Question 7

Do you agree with how the market participant view is articulated in SFAS 157? Why or why not?

Response

Agreed.

Question 8

Do you agree that the market participant view in SFAS 157 is consistent with the concepts of 'knowledgeable, willing parties' and 'arm's length transaction' as defined in IFRSs? If not, how do you believe they differ?

<u>Response</u>

Agreed.

<u>Issue 2C – Transfer versus settlement of a liability</u>

Question 9

Do you agree that the fair value of a liability should be based on the price that would be paid to transfer the liability to a market participant? Why or why not?

<u>Response</u>

On the premise that we accept the definition of fair value in this Standard, any method that subscribes to market participants' view will be deemed better than any method that gravitate towards the entity's specific view.

The term "settlement" implies greater emphasis is placed on entity specific conditions such as efficiency or inefficiency of the entity, while the term "transfer" implies greater emphasis on the market participants' expectation of the price they would accept in order to ultimately settle the obligation with the counter party.

Conceptually, if the market is perfect, measuring fair value via the concept of "settlement" and "transfer" should yield the same result.

However, in practice there will not always be a perfect market and in a lesser than perfect market an entity's specific efficiency and inefficiency may not be discounted into the market. In such circumstances the "settlement" notion would not provide better fair value measurement as it is biased towards entity specific value. Notwithstanding the above, it must not be ignored that in reality the focus is on the cash flow settlement.

Question 10

Does the transfer measurement objective for liabilities in SFAS 157 differ from fair value measurements required by IFRSs as applied in practice? If so, in practice which fair value measurements under IFRSs differ from the transfer measurement objective in SFAS 157 and how do they differ?

Response

The application of fair value in IFRS is also market orientated. Thus, in principle the concept of "transfer" may be in line with IFRSs. However, it must not be ignored that in reality the focus is on the cash flow settlement, which is what is currently defined in IFRSs, ie "... or liability settled ...".

Issue 3 – Transaction price and fair value at initial recognition

Question 11

In your view is it appropriate to use a measurement that includes inputs that are not observable in a market as fair value at initial recognition, even if this measurement differs from the transaction price? Alternatively, in you view, in the absence of a fair value measurement based solely on observable market inputs, should the transaction price be presumed to be fair value at initial recognition, thereby potentially resulting in the deferral of day-one gains and losses? Please give reasons for your views.

Response

A transaction price is a negotiated price, during the process of negotiation one cannot always assume that both parties are:

- **independent of the reporting entity**
- **knowledgeable**
- **willing**
- **able to transact**

Therefore the use of fair value will highlight the inherent strength and weakness of the entity. This can be observed from day one gain or loss.

However, if input data are not observable from market place, any fair value derived from the valuation model is questionable. Under such circumstances one would prefer the transaction price. At least this has been negotiated although it may be biased for reason stated above.

Therefore in the absence of a fair value measurement based solely on observable market inputs, in our view, the transaction price should deemed to be the fair value at initial recognition, thus effectively eliminate day one gain or loss.

Question 12

Do you believe that the provisions of SFAS 157, considered in conjunction with the unit of account guidance in IAS 39, would result in a portfolio-based valuation of identifiable risks of instruments considered in aggregate, or an in-exchange exit price for the individual instruments? Please give reasons for your views.

Response

It would not result in a blanket use of portfolio-based valuation of identifiable risks of instruments considered in aggregate, because the unit of guidance in IAS 39 is based on individual financial asset and financial liability. The provision of level 1 to level 3 in SFAS 157 would appear to be capable of being applied to individual or group of financial assets and liabilities. Nonetheless, we wish to emphasize that any portfolio valuation should be allowed if and only if the items have similar characteristics and risks profile.

With reference to SFAS 157 paragraph 6 which states that a fair value measurement is for a particular asset or liability, the asset or liability might be a stand-alone asset or liability or a group of assets and liabilities. Such a concept is also used in IAS 39 in the impairment of financial assets. In addition, the unit of account for the asset or liability should be determined in accordance with the provisions of other accounting pronouncements such as IAS 16 on the unit of measurement based on the concept of items and parts. IAS 36 on impairment of assets is based on individual asset and cash generating unit.

Issue 4 – Principal (or most advantageous) market

Question 13

Do you agree that a fair value measurement should be based on the principal market for the asset or liability or, in the absence of a principal market, the most advantageous market for the asset or liability? Why or why not?

Response

Based on the definition of principal market (the market in which the reporting entity would sell the asset or transfer the liability with the greatest volume and level of activity) we would agree that the first choice of market to determine fair value should be the principal market as this would be generally more easily accessible and would eliminate the burden of constantly seeking for the most advantageous market. However, in the absence of a principal market, then the entity shall seek for the most advantageous market.

Issue 5 – Attributes specific to the asset or liability

Question 14

Do you agree that a fair value measurement should consider attributes specific to the asset or liability that market participants would consider in pricing the asset or liability? If not, why?

Response

Yes, attributes specific to the asset or liability should be considered in the measurement of fair value. For example market participants would consider the size of the asset, in the case of the plantation, location, condition and age of the asset in the case of a building in pricing the asset.

Question 15

Do you agree that transaction costs that would be incurred to a transaction to sell an asset or transfer a liability are an attribute of the transaction and not of the asset or liability? If not, why?

Response

Yes, transaction costs can often be entity specific cost and do not reflect market valuation whereas attribute of the asset / (liability) would contribute to the inflow / (outflow) of the entity's future economic resources.

Issue 6 – Valuation of liabilities

Question 16

Do you agree that the risk of non-performance, including credit risk, should be considered in measuring the fair value of a liability? If not, why?

Response

Yes, credit risk is an important factor in deciding fair value of a liability in the market.

Issue 7 – 'In-use valuation premise' versus 'value in use'

Question 17

Is it clear that the 'in-use valuation premise' used to measure the fair value of an asset in SFAS 157 is different from 'value in use' in IAS 36? Why or why not?

Response

Yes, "in-use valuation premise" is based on market participants' highest and best use of the assets while "value-in-use" is an entity specific value.

However, the two terms could confuse readers if used in the same document. Choosing alternative wordings will alleviate the confusion.

Issue 8 – Fair value hierarchy

Question 18

Do you agree with the hierarchy in SFAS 157? If not, why?

Response

The hierarchy in SFAS 157 is no different from that prescribed in IASB except that the former is more prescriptive compared to the latter which is principles based.

Nonetheless, the hierarchy in SFAS 157 would result in application issues as there is no clear dividing line, particularly between level 2 and level 3 where there could be an overlap. Entities may not be aware of quoted prices for similar assets in another market and hence, may have used unobservable inputs as prescribed in level 3 instead.

In addition, level 2 may result in fair values which are inappropriate because a hypothetical market is assumed, eg quoted prices in an inactive market. Level 3 may result in similar outcome as entities are required to look for assumptions market participant would use in valuing the assets and liabilities even though no such markets or market participants exist. In such case, how does an entity draw a line between similar assets in an inactive market with that of unobservable data as described in level 3?

Question 19

Are the differences between the levels of the hierarchy clear? If not, what additional information would be helpful in clarifying the differences between the levels?

Response

Although the differences between the levels of the hierarchy are clear, their application may not be clear in practice. More guidance on what parameters are observable or otherwise, together with examples of 'observable' and 'unobservable' is required.

Issue 9 – Large positions of a single financial instrument (blocks)

Question 20

Do you agree with the provision of SFAS 157 that a blockage adjustment should be prohibited for financial instruments when there is a price for the financial instrument in an active market (Level 1)?

In addition, do you agree that this provision should apply as a principle to all levels of the hierarchy? Please provide a basis for your views.

Response

It seems to us that by not advocating blockage adjustments is the easy way out for fair value measurement that can have far reaching consequences in practice.

Issue 10 – Measuring fair value within the bid-ask spread

Question 21

Do you agree that fair value measurements should be determined using the price within the bid-ask spread that is most representative of fair value in the circumstances, as prescribed by paragraph 31 of SFAS 157?

Alternatively, do you believe that the guidance contained in IFRSs, which generally requires assets to be valued at the bid price and liabilities at the ask price, is more appropriate? Please explain the basis for your view.

Response

The pro of determining fair value using the most advantageous price within the bid-ask spread is that it incorporates information that best represent the trading condition at one point in time, this is similar to the use of weighted average rather than simple average (which is mid-price).

However, this method may require a high degree of judgement in deciding at which point within the bid-ask spread to choose from, in particular when the spread is too wide (statistically, it could be in the mode, median or the mean range). This may result in a loss of consistency in application and loss of comparability of fair value.

The current structure of IFRS however, promotes consistency of measurement for assets at bid-price and liability at ask-price.

We would prefer the current IFRS structure which preserve consistency and comparability and eliminate excessive judgement.

Question 22

Should a pricing convention (such as mid-market pricing or bid price for assets and ask price for liabilities) be allowed even when another price within the bid-ask spread might be more representative of fair value? Why or why not?

Response

See response above. In addition, be it a pricing convention or another price within the bid-ask spread is used, it should be applied consistently.

Question 23

Should bid-ask pricing guidance apply to all levels of the hierarchy, including when the fair value measurement includes unobservable inputs? Why or why not?

Response

No. Bid-ask price is a characteristic of an active market and only suitable for level 1. Applying the bid-ask price to level 2 and level 3 hierarchies would not be appropriate, particularly in level 3 as all data are unobservable and hence, the concept of bid-ask price in this environment is obscured.

Issue 11 – Disclosures

Question 24

Do the disclosure requirements of SFAS 157 provide sufficient information? If not, what additional disclosures do you believe would be helpful to users and why?

Alternatively, are there disclosures required by SFAS 157 that you believe are excessive or not beneficial when considered in conjunction with other disclosures required by IFRSs? Please provide a basis for your view.

Response

Yes, it does provide sufficient information. The disclosure requirement of this Standard would complement the disclosure requirements of other IFRSs.

Issue 12 – Application guidance

Question 25

Does the guidance in Appendices A and B of SFAS 157 sufficiently illustrate the standard's principles and provisions as they would apply under IFRSs? If not, please specify what additional guidance you believe is needed and why.

Response

The guidance in Appendices A and B of SFAS 157 are applicable for developed economies where market data is readily available. However, this is not the case in developing economies where there availability of information and other market data are limited.

Question 26

Does the additional guidance in Appendices A and B of SFAS 157 sufficiently illustrate the standard's principles and provisions as they would apply in emerging or developing markets? If not, please specify what additional guidance you believe is needed and the most effective way to provide this guidance (for example, through additional implementation guidance or through focused education efforts).

Response

No, more explicit implementation guidance is required for developing markets to be able to comply with the proposals in this DP. For example, in developing markets, a single block of financial instruments transacted will likely to have an effect on the market.

Issue 13 – Others matters

Question 27

Please provide comments on any other matters raised by the discussion paper

Response

See the preamble in our cover letter.