23rd October 2006

IAS 32 and IAS 1 Amendments
International Accounting Standards Board (“IASB”)
30 Cannon Street
LONDON EC4M 6XH
UNITED KINGDOM

Dear Sir David,

**Re: ED of Amendments to IAS 32 *Financial Instruments: Presentation* and IAS 1 *Presentation of Financial Statements***
**– Financial Instruments Puttable at Fair Value and Obligations Arising on Liquidation**

The Malaysian Accounting Standards Board (“MASB”) appreciates the opportunity to offer its views on Exposure Draft of Proposed Amendments to IAS 32 and IAS 1 in relation to financial instruments puttable at fair value and obligations arising on liquidation (the ED).

We commend the efforts of IASB to improve the financial reporting of financial instruments puttable at fair value and instruments with obligations arising on liquidation that have characteristics similar to ordinary shares. We support IASB’s decision to respond urgently to the need for additional guidance for the application of the standard on selected matters.

We agree that certain specific categories of financial instruments merit specific treatment. These financial instruments include financial instruments puttable at fair value and obligations to deliver to another entity a pro rata share of net assets of the entity upon its liquidation. Whilst possessing the ownership features typical of an equity instrument, they include terms that meet the definition of a liability under IAS 32.

Whilst we recognise the immediate benefit of a quick fix to IAS 32 to cater for such specific categories of financial instruments, we have reservation on this short-term solution, as it would result in a deviation from the present fundamental

approach for the presentation and disclosure of financial instruments contained in IAS 32. We noted that IASB and the Financial Accounting Standards Board ("FASB") are working together on a comprehensive project on distinguishing debt from equity. We suggest that IASB escalates the priority of this project.

Alternatively as another short-term solution, IASB may wish to consider scoping out such financial instruments from IAS 32 due to their peculiar features. This should then be followed by IASB developing a separate framework for such financial instruments. The separate framework would cater for the special purposes carried by certain specific issuers e.g. collective investment funds, co-operative societies, limited purpose/life partnerships etc. The nature of such entities issuing such financial instruments is different from that of a normal business entity which the existing Framework has focused on. This alternative would also avoid making an exception to the fundamental approach for financial liabilities and equity contained in IAS 32.

On the specific questions raised in the ED, we are pleased to submit our responses in an Appendix to this letter.

Should you require further information, please contact Dr. Nordin Mohd Zain, the Executive Director of MASB, via e-mail at nordin@masb.org.my.

Yours sincerely,

**Dato' Zainal Abidin Putih**
Chairman

**ED of Amendments to IAS 32 *Financial Instruments: Presentation* and IAS 1 *Presentation of Financial Statements* – Financial Instruments Puttable at Fair Value and Obligations Arising on Liquidation**

**Question 1 - Financial instruments puttable at fair value**

The Exposure Draft proposes that financial instruments puttable at fair value should be classified as equity, provided that specified criteria are met.

Do you agree that it is appropriate to classify as equity financial instruments puttable at fair value? If so, do you agree that the specified criteria for equity classification are appropriate? If not, why? What changes do you propose, and why? If you disagree with equity classification of financial instruments puttable at fair value, why?

**Response:**

**We agree that certain specific categories of financial instruments, including financial instruments puttable at fair value merit specific treatment. Nevertheless, we do not support the proposal of making an exception to the fundamental approach for financial liabilities and equity contained in IAS 32 and classifying such instruments as equity.**

**Alternatively, we propose IASB to consider scoping out such financial instruments from IAS 32 due to their peculiar features. This should then be followed by IASB developing a separate framework for such financial instruments. The separate framework would incorporate and cater for the special purposes carried by certain specific issuers e.g. collective investment funds, co-operative societies, limited purpose/life partnerships etc. The nature of such entities issuing such financial instruments is different from that of a normal business entity which the existing Framework has focused on. This alternative would also avoid making an exception to the fundamental approach for financial liabilities and equity contained in IAS 32.**

**In addition, we noted the following anomaly in the specified criteria for equity classification:**

- **The issue price and redemption/repurchase price received and paid by the issuing entity must be the financial instrument's fair value determined in accordance with the requirements of IAS 39 (as required under paragraph AG14A of the Application Guidance of the ED);**

- **In practice, the rules of which the issuers based upon to determine the net asset value ("NAV") of such financial instruments (e.g. investment funds) is also used to determine the issuance and redemption / repurchase prices and this is different from the requirements of IAS 39. For instance, most rules applicable to investment funds require the investments to be valued at last known transaction prices or mid market prices, whilst IAS 39 requires current bid prices (for long position) and ask prices (for short position) to be used;**

- **Thus, in practice, the issue price and redemption/repurchase price of such financial instruments issued by most investment funds are not at the value determined in accordance with IAS 39;**

- **Following from the above, it could mean that this amendment to IAS 32 would not be available to the financial instruments puttable at fair value issued by most investment funds. We suggest IASB to consider whether the fair value is allowed to be determined using rules other than IAS 39's as long as the difference (from the fair value determined using IAS 39 requirements) is not material.**

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**Question 2 - Obligations to deliver to another entity a pro rata share of the net assets of the entity upon its liquidation**

The Exposure Draft proposes that an instrument that imposes on the entity an obligation to deliver to another entity a pro rata share of the net assets of the entity upon its liquidation should be classified as equity, provided that specified criteria are met (e.g. ordinary shares issued by a limited life entity).

Do you agree that it is appropriate to classify as equity these types of instruments? If so, do you agree that the specified criteria for equity classification are appropriate? If not, why? What changes do you propose, and why? If you disagree with equity classification for these types of instruments, why?

**<u>Response:</u>**

**Our comment to Question (1) also applies to this Question. We do not support the proposal of making an exception to the fundamental approach for financial liabilities and equity contained in IAS 32 and classifying such instruments as equity.**

**Alternatively, to consider scoping out such financial instruments from IAS 32 due to their peculiar features, then followed by IASB developing a separate framework which would incorporate and cater for the special purposes carried by certain specific issuers e.g. collective investment funds, co-operative societies, limited purpose/life partnerships etc.**

**In addition, we have the following specific comments:**

**(c)** **The phrase 'most subordinated class' introduced in one of the features in 'a financial instrument that entitles the holder to a pro rata share of the net assets of the entity' is a new notion in the IFRS literature. The notion, therefore, needs to be comprehensively explained in the Basis for Conclusion.**

**(d)** **Paragraph AG14G of the Application Guidance: We are of the view that the phrase "… a pro rata share of …" towards the end of the first paragraph should be removed. We believe the phrase is not relevant in this context which refers to any amount (and not only a pro rata share). Therefore, the revised sentence [deletion per struck through] should read:**

> **"*For an instrument to have an entitlement to a pro rata share of the net assets of the entity, the terms and conditions of the instrument shall not, to any extent, have the effect of providing the instrument holder with an entitlement to ~~a pro rata share of~~ the entity's net assets that: (a) is a fixed or specified amount; (b) changes over time …*".**

**(e)** **Paragraph AG29A of the Application Guidance (treatment in consolidated financial statements) states that: "the financial instruments held by minority interests are not in the group's most subordinated class of instruments … because, if the group were to liquidate, the claims of minority interest holders to the net assets of**

**the subsidiary have to be satisfied first before the parent's share of the net assets of the subsidiary can be distributed to the claimants to the assets of the parent."**

**We do not agree with this conclusion and the rationale stated due to the reasons explained below:**

**(i) In the absence of any agreements to the contrary and when the said financial instruments are in the most subordinated class of instruments of the subsidiary, the parent company and the minority interests would rank pari passu in the claims on the net assets of the subsidiary. The minority interests would not have priority in the distribution of the net assets, and each of the parent company and the minority interests would be entitled a pro rata share of remaining net assets after the claims of the more senior claimants have been satisfied.**

**(ii) Therefore, the said financial instruments held by minority interests, similar to the said financial instruments held by the parent company (reflected through the parent's own equity in the group financial statements after the financial instruments issued by the subsidiary is eliminated in consolidation) are in the group's most subordinated class of instruments in relation to the net assets of the subsidiary.**

**(iii) The minority interests have no claim on other net assets in the group other than the subsidiary where it has interest. Thus, in situation where the parent is liquidated, the question of satisfying the minority interests' claim would not arise on these other net assets of the group, whilst the parent company and the minority interests rank pari passu in relation to their claims over the net assets of the said subsidiary.**

**(iv) The above is no different from the situation of other equity instruments issued by another subsidiary which are held by the minority interests, and which are currently classified as equity in accordance with IAS 27.**

**(v) Thus, we suggest IASB to reconsider the conclusion and rationale stated in paragraph AG29A taking into account the analysis above.**

**Question 3 - Disclosures**

The Exposure Draft proposes disclosures about financial instruments puttable at fair value classified as equity, including the fair values of these instruments, and the reclassification of financial instruments puttable at fair value and instruments that impose an obligation arising on liquidation between financial liabilities and equity.

(a) Do you agree that it is appropriate to require additional information about financial instruments puttable at fair value classified as equity, including the fair values of these instruments? If so, do you agree that the fair value disclosures should be required at every reporting date? If not, why? What changes do you propose, and why?

(b) Do you agree that it is appropriate to require disclosure of information about the reclassification of financial instruments puttable at fair value and instruments that impose an obligation arising on liquidation between financial liabilities and equity? If not, why? What changes do you propose, and why?

**Response:**

**We do not have objections to the proposals.**

***Question 3(b)***

**If IASB decides to proceed with the proposals, we believe the disclosure of information about the reclassification of financial instruments referred to in (b) is appropriate.**

**Question 4 - Effective date and transition**

The proposed changes would be required to be applied retrospectively, from a date to be determined by the Board after exposure (with one exception permitted relating to compound instruments). Earlier application would be encouraged.

Are the transition provisions appropriate? If not, what do you propose, and why?

**Response:**

**As indicated above in the letter, we have reservation as to the approach and treatment proposed in the ED for such compound financial instruments. However, if the IASB so decide to proceed with the proposals, we agree that they should be applied retrospectively.**