mASB MALAYSIAN ACCOUNTING STANDARDS BOARD
LEMBAGA PIAWAIAN PERAKAUNAN MALAYSIA

14 September 2009

Sir David Tweedie
Chairman
International Accounting Standards Board (IASB)
30 Cannon Street
London ED 4M 6 XH
United Kingdom

Dear Sir David

**IASB EXPOSURE DRAFT – FINANCIAL INSTRUMENTS: CLASSIFICATION AND MEASUREMENT**

The Malaysian Accounting Standards Board welcomes the opportunity to provide comments on the IASB Exposure Draft - Financial Instruments: Classification and Measurement (ED).

We appreciate the IASB commitment to reduce the complexity of the accounting for financial instruments so as to improve the ability of users of financial statements to assess the amounts, timing and uncertainty of future cash flows.

Having reviewed the ED, we generally support the proposals. Nevertheless, we would like the following subject matters to be considered and deliberated further before the final proposal is drawn up.

***Application of the two conditions in paragraph 4 to Islamic financial instruments***

These two conditions define 'basic financial instruments' that can be carried at amortised cost. Whilst we can readily relate these conditions to most instruments which are intended to be realised via non-trading activities, the said conditions may not be sufficiently comprehensive or clear enough to include certain Islamic financial instruments currently being used in the local market.

For example, Musharakah and Mudharabah financing are two common types of financing facilities granted by Islamic financial institutions to their customers. Both these contracts are essentially profit sharing agreements where the return is derived from the financial outcome of a venture which may be neither publically observable or market based.

It is not clear how these rules are meant to relate to financing contracts whose returns may be more from profit sharing than time-based returns. To carry them at fair value through profit or loss may not be appropriate as they are considered normal financing facilities for Islamic financial institutions and are generally non-tradable financial instruments.

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Another comment was that the term "interest" used in the Exposure Draft may not be comprehensive enough to cover income of all types of basic financial instruments. Typically, the income earned on Islamic financial instruments is referred to not as 'interest' but 'profit' or 'income'.

In addition, from the shariah viewpoint, such a term being used to cover such contracts, may "taint" the Islamic financial instruments given the strict prohibition on interest.

Accordingly, we would like to suggest that the Board revisit the conditions (including terms and definitions) used in paragraph 4 to ensure that all known 'basic financial instruments' would not be disqualified from using amortised cost as the measurement basis.

The issuers and holders of Islamic financial instruments are from both Islamic and non-Islamic entities, there is a need to ensure these financial instruments are properly treated in their financial statements.

We would be pleased to provide further information and analysis on Islamic financial instruments for this purpose to the Board if necessary.

***Application of the two conditions in paragraph 4 to other 'normal' financial instruments***

Following from the last point discussed above, in addition to Islamic financial instruments, we also have concerns whether the said two conditions are sufficiently comprehensive to include most other financial instruments that are considered 'normal' and thus be allowed to be carried at amortised cost.

For example, it is not uncommon in venture capital industry for venture capitalists to provide additional financing to investees with equity options (as a form of 'collateral' to encourage the entrepreneurs or the business owners to repay the financing, and/or to facilitate recovery process if the amount could not be repaid).

In addition we are also concerned whether the word "loan" used in “basic loan features”, though intended to apply to a wide range of instruments, could create some confusion as receivables / payables are not seen as "loans". Therefore to add clarity to the Standard, it would be good if the revised Standard could further elaborate the meaning of “loan” to mitigate any unintended consequence that may arise when implementing the new requirements.

***Requirement to measure all equity instruments at fair value***

We are doubtful if this requirement will provide improved decision-useful information to users as compared to the existing requirements of IAS 39.

Whilst we do not dispute that fair value provides information that is relevant to users, we believe it may not always be possible to obtain reliable information to measure fair values of certain equity investments that do not have quoted market prices in active markets; for example, unquoted equity shares issued by financial-troubled obligors in restructuring schemes to repay existing debts.

In our view, the proposal will result in entities using highly judgemental unobservable information in order to determine the fair value of these unquoted equity investments since it is unlikely observable data will be available. We are concerned this will compromise the quality of information generated for users. We believe it would be more meaningful to provide sufficient disclosures on these instruments rather than arbitrarily determining their fair values.

In addition, we believe it would involve considerable costs to obtain the necessary information to perform a valuation which will most likely outweigh the presumed benefit of the fair value requirements for this type of equity instruments.

To this we strongly recommend that the IASB maintains the exemption of IAS 39 to allow entities to measure at cost investments in equity instruments that do not have a quoted market price in an active market and whose fair value cannot be reliably measured.

***Dividend income of certain equity investments in which fair value changes are recorded in other comprehensive income (OCI)***

We support the proposal to require the presentation of fair value changes in OCI where an entity elects to present fair value changes for particular equity investments in OCI (where the investment is not held for trading purposes).

However, we are unsure if the case has been made whether it is appropriate to record the dividends from these investments in OCI. Whilst recording fair value changes of these investments in OCI reflect their 'non-trading' and/or 'strategic' nature, recording the dividends in OCI may have a misleading impression that they are: 'non-productive' and/or behave like 'zero-coupon' instruments. In addition, this would complicate the process of determining distributable reserves in some jurisdictions (retained profits are distributable while OCI most likely is not).

***Reclassification***

We are of the view that reclassifications should be permitted if it reflects the true economic nature of financial instruments. It is not always true that an entity will not change its business model. We recommend IASB to consider allowing reclassification under exception circumstances, eg due to changes of tax laws, capital regulations, business combinations.

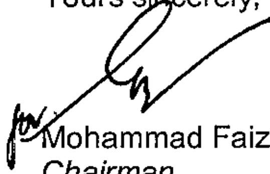
When that happens, financial instruments previously managed on a contractual yield basis would no longer be managed on that basis, or vice versa. Hence when such

change takes place, it would be inappropriate to maintain the existing measurement basis that will not reflect the economic nature of the instrument. For this reason, we believe a principle-based approach should be adopted to allow for judgement to be exercised by the entity. In this regard, significant disclosures should be required if reclassification occur to enhance comparability and understandability by users.

If you need further clarification, please contact Ms Tan Bee Leng at +603 2240 9200 or by email at beeleng@masb.org.my.

Thank you.

Yours sincerely,



Mohammad Faiz Azmi
*Chairman*