MASB MALAYSIAN ACCOUNTING STANDARDS BOARD
LEMBAGA PIAWAIAN PERAKAUNAN MALAYSIA

9 March 2011

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

Dear Sir David

IASB EXPOSURE DRAFT – Hedge Accounting

The Malaysian Accounting Standards Board welcomes the opportunity to provide comments on the IASB Exposure Draft ("ED") – Hedge Accounting.

We appreciate the IASB's initiative to improve the financial instruments accounting model for hedging and we welcome the principles for hedge accounting brought by the ED which serves to closer align financial reporting with the risk management activities undertaken by the entities. The ED also addressed some of the more operationally onerous requirements such as quantitative threshold and prospective assessment for hedge effectiveness testing.

In principle we agree with the general direction of the ED which establishes a clear link between hedge accounting and the entity's risk management strategies and activities. The ED states that the objective of hedge accounting is to represent the effect of an entity's risk management activities. However we have a concern with the ED which only allows hedge accounting to be applied for risks that affect profit or loss. We believe that risks that affect other comprehensive income ("OCI") such as risks attributable to investments in equity instruments measured at fair value through OCI, could also and have been meaningfully managed as part of certain entities' risk management strategies, and hence prohibiting hedge accounting on these risk management activities would not allow the financial statements to effectively reflect the economic substance of the underlying transactions of these entities.

In addition we also believe there is a need for more robust disclosures in particular when an entity is allowed to proactively rebalance its hedge relationships. The concept of rebalancing could be misused and its evaluation requires substantial judgment. We propose that circumstances leading to the proactive rebalancing and its frequency be disclosed to enhance greater understanding of the entity's risk management activities and to promote accountability.

Our detailed responses are enclosed in the Appendix of this letter. If you need further clarification or have any queries regarding this letter, please contact Ms Christine Lau at +603 2240 9200 or by email at christine@masb.org.my

Yours sincerely

Mohammad Faiz Azmi
Chairman

Appendix

Question 1

Do you agree with the proposed objective of hedge accounting? Why or why not? If not, what changes do you recommend and why?

We agree with the proposed objective of hedge accounting which is to represent the effect of an entity's risk management activities. However we do have a concern with the proposal which only allows hedge accounting to be applied for risks that affect profit or loss. We believe the risks that affect other comprehensive income ("OCI") such as investment in equity instruments measured at fair value through OCI as well as pension obligations under defined benefit scheme can be managed meaningfully as part of the entity's risk management strategies, and hence prohibiting hedge accounting for these risks would not allowed the financial statements to effectively represent the risk management activities of the entity. We would like to suggest that the Board reconsider such a prohibition.

Question 2

Do you agree that a non-derivative financial asset and a non-derivative financial liability measured at fair value through profit or loss should be eligible hedging instruments? Why or why not? If not, what changes do you recommend and why?

We agree with the proposal to include non-derivative financial asset and non-derivative financial liability measured at fair value through profit or loss as eligible hedging instruments. As we have mentioned in our response to Q1, we would also like to propose that non-derivative financial assets and liabilities measured at fair value through OCI be included as eligible hedging instruments as the objective of hedge accounting is to represent the risk management activities of the entity.

Question 3

Do you agree that an aggregated exposure that is a combination of another exposure and a derivative may be designated as a hedged item? Why or why not? If not, what changes do you recommend and why?

We agree with the proposal as long as the management of the aggregated risk exposure is consistent with the risk management strategy of the entity.

Question 4

Do you agree that an entity should be allowed to designate as a hedged item in a hedging relationship changes in the cash flows or fair value of an item attributable to a specific risk or risks (ie a risk component), provided that the risk component is separately identifiable and reliably measurable? Why or why not? If not, what changes do you recommend and why?

We agree that an entity be allowed to designate risk components as hedged items as long as the risk component is separately identifiable and reliably measured. We believe this proposal would bring close alignment of risk management strategies to accounting treatment.

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Question 5

(a) Do you agree that an entity should be allowed to designate a layer of the nominal amount of an item as the hedged item? Why or why not? If not, what changes do you recommend and why?

We support the proposal to allow an entity to designate a layer of the nominal amount of an item as a hedged item as long as this is consistent with the risk management strategy of the entity. This proposal would address issues currently faced by many entities which manage layer components in their risk management strategies.

(b) Do you agree that a layer component of a contract that includes a prepayment option should not be eligible as a hedged item in a fair value hedge if the option's fair value is affected by changes in the hedged risk? Why or why not? If not, what changes do you recommend and why?

We agree with the Board that a layer component of contract that includes a prepayment option should not be eligible as a hedged item in a fair value hedge if the option's fair value is affected by changes in the hedged risk as allowing it would result in a designation of a risk component that is not separately identifiable.

Question 6

Do you agree with the hedge effectiveness requirements as a qualifying criterion for hedge accounting? Why or why not? If not, what do you think the requirements should be?

We agree with the elimination of the 80-125% bright line test for assessing and measuring hedge effectiveness. This proposal is a significant move towards a principle based framework and has the effect of simplifying the application of hedge accounting and closer aligning it to the entity's risk management strategy.

Question 7

(a) Do you agree that if the hedging relationship fails to meet the objective of the hedge effectiveness assessment an entity should be required to rebalance the hedging relationship, provided that the risk management objective for a hedging relationship remains the same? Why or why not? If not, what changes do you recommend and why?

If the risk management objective for the hedging relationship remains the same, we agree that rebalancing is required. Rebalancing is an operationally more attractive and flexible approach as compared to discontinuation and restarting a hedge relationship. The requirement to disclose and update the analysis of the sources of hedge ineffectiveness associated with each rebalancing provides useful information to the users. We propose that circumstances leading to the rebalancing and its frequency be disclosed to enhance greater understanding of the entity's risk management activities and to promote accountability.

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(b) Do you agree that if an entity expects that a designated hedging relationship might fail to meet the objective of the hedge effectiveness assessment in the future, it may also proactively rebalance the hedge relationship? Why or why not? If not, what changes do you recommend and why?

We propose that rebalancing should be allowed only when the hedge effectiveness test is not met. Proactive rebalancing can be considered where the entity's risk management function is proven to be sufficiently robust and there is a strong governance framework over the management of such risk management activities. As proactive rebalancing requires a greater degree of judgment, we propose the circumstances leading to the proactive rebalancing and its frequency be disclosed to enhance a greater understanding of the risk management activities of the entity. This also serves as a way to promote the entity's stewardship accountability in respect of its risk management activities.

Question 8

(a) Do you agree that an entity should discontinue hedge accounting prospectively only when the hedging relationship (or part of a hedging relationship) ceases to meet the qualifying criteria (after taking into account any rebalancing of the hedging relationship, if applicable)? Why or why not? If not, what changes do you recommend and why?

Yes, we agree that the entity should only discontinue hedge accounting prospectively only when the hedging relationship ceases to meet the qualifying criteria.

(b) Do you agree that an entity should not be permitted to discontinue hedge accounting for a hedging relationship that still meets the risk management objective and strategy on the basis of which it qualified for hedge accounting and that continues to meet all other qualifying criteria? Why or why not? If not, what changes do you recommend and why?

We agree that an entity should not be permitted to discontinue hedge accounting if the hedging relationship still meets the risk management objective. This is consistent with the principal objective of the hedge accounting which is to represent the effect of an entity's risk management activities. Any deviation from this overriding principle may lead to possible manipulation in earnings of the entity.

Question 9

(a) Do you agree that for a fair value hedge the gain or loss on the hedging instrument and the hedged item should be recognised in other comprehensive income with the ineffective portion of the gain or loss transferred to profit or loss? Why or why not? If not, what changes do you recommend and why?

We agree with the proposal to recognise the ineffective portion of the hedging relationship to profit or loss. But we propose to only present the line that represents the ineffective portion in the statement of other comprehensive income ("OCI"), with the gross amounts of the gain or loss on the hedging instrument and the hedged item in an appropriate note to the financial statements. We have a concern that the statement of comprehensive income could be 'over-crowded' and thus reduces its usefulness.

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The ED proposes a two-step approach to present the effect of the hedging relationship to the entity's profit or loss. The two-step involved the posting of gains or losses attributable to the hedged item and hedging instrument to OCI followed by the transfer of the ineffective portion of the hedging relationship from OCI to profit or loss. We are of the view that presenting three line items in OCI could potentially obscure the clarity of the information that is intended to be presented as these three line items could represent the aggregated effects of various hedging strategies and relationships with varying degree of hedge ineffectiveness. Therefore, we would like to suggest presenting as two line items (one line for total of ineffective portions of the hedging relations, with the second line as the transfer of the same total amount to profit or loss) in the statement of OCI to be supplemented by the appropriate disclosures in the note to the financial statements.

(b) Do you agree that the gain or loss on the hedged item attributable to the hedged risk should be presented as a separate line item in the statement of financial position? Why or why not? If not, what changes do you recommend and why?

We agree with the presentation of gains or losses on the hedged item attributable to the hedged risk be presented as a separate line item in the statement of financial position. However, if the entity applies hedge accounting to a wide range of assets and liabilities, the proposed presentation could substantially increase the number of line items presented on the face of the statement of financial position. We would therefore like to suggest presenting the fair value hedge adjustments of all the hedged items involved as a single line or net amount on the statement of financial position, accompanied by relevant disclosure on the associated gains or losses of the respective hedge items in the note to the financial statements.

(c) Do you agree that linked presentation should not be allowed for fair value hedges? Why or why not? If you disagree, when do you think linked presentation should be allowed and how should it be presented?

We agree with the Board that linked presentation should not be allowed for fair value hedges as this presentation does not provide useful information to the users. As in most circumstances not all the risks of a hedged item are covered in a hedging relationship, it is not meaningful to bring the hedged item and the hedging instruments together in the linked presentation.

Question 10

(a) Do you agree that for transaction related hedged items, the change in fair value of the option's time value accumulated in other comprehensive income should be reclassified in accordance with the general requirements (eg like a basis adjustment if capitalised into a non-financial asset or into profit or loss when hedged sales affect profit or loss)? Why or why not? If not, what changes do you recommend and why?

(b) Do you agree that for period related hedged items, the part of the aligned time value that relates to the current period should be transferred from accumulated other comprehensive income to profit or loss on a rational basis? Why or why not? If not, what changes do you recommend and why?

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(c) Do you agree that the accounting for the time value of options should apply to the extent that the time value determined using the valuation of an option that would have critical terms that perfectly match the hedged item)? Why or why not? If not, what changes do you recommend and why?

We agree that changes in fair value of the option's time value accumulated in other comprehensive income be reclassified in accordance with the requirements stated in (a) and (b) above even though this may potentially introduce additional operationally complexity to the application of hedge accounting. We also agree with the requirement stated in (c) above for the treatment of the time value.

In addition, we propose that the Board should also allow the same treatment for the interest element in a forward contract. The interest element is also a cost of hedging which is not avoidable in most circumstances.

Question 11

Do you agree with the criteria for the eligibility of groups of items as a hedged item? Why or why not? If not, what changes do you recommend and why?

We support the Board's view that an individual hedge approach and a group hedge approach are similar in nature and hence the requirements for qualifying for hedge accounting are similar. We therefore agree with the proposed criteria for the eligibility of group of items as a hedged item and we believe this is a positive step towards the development of appropriate principles for macro hedging.

Question 12

Do you agree that for a hedge of a group of items with offsetting risk positions that affect different line items in the income statement (eg in a net position hedge), any hedging instrument gains or losses recognised in profit or loss should be presented in a separate line from those affected by the hedged items? Why or why not? If not, what changes do you recommend and why?

We agree with the proposal to present the gains or losses associated with the hedging instrument in a separate line from those affected by the hedged items. As noted in our response to Q9, we would like suggest presenting the fair value hedge adjustment of the hedging instrument as a single net amount on the statement of financial position, accompanied by relevant disclosure on the associated gains or losses of the respective hedge items and hedging instruments in the note to the financial statements.

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Question 13

(a) Do you agree with the proposed disclosure requirements? Why or why not? If not, what changes do you recommend and why?

(b) What other disclosures do you believe would provide useful information (whether in addition to or instead of the proposed disclosures) and why?

The proposed disclosures provide users an understanding of the entity's risk management strategies and how these impact its reported earnings and statement of financial position. Whilst we agree with the proposed disclosure requirements, we believe the Board should consider how best to align the disclosure requirements in this ED with IFRS 7's.

Please refer to our replies to Q7 (a) and (b), and Q9 (a) and (b) above for other disclosures that we have proposed.

Question 14

Do you agree that if it is in accordance with the entity's fair value-based risk management strategy derivative accounting would apply to contracts that can be settled net in cash that were entered into and continue to be held for the purpose of the receipt or delivery of a non-financial item in accordance with the entity's expected purchase, sale or usage requirements? Why or why not? If not, what changes do you recommend and why?

We agree with the above proposal as this would better reflect the entity's risk management activities in financial reporting.

Question 15

(a) Do you agree that all of the three alternative accounting treatments (other than hedge accounting) to account for hedges of credit risk using credit derivatives would add unnecessary complexity to accounting for financial instruments? Why or why not?

(b) If not, which of the three alternatives considered by the Board in paragraphs BC226-BC246 should the Board develop further and what changes to that alternative would you recommend and why?

The Board has identified three alternative approaches to address situations in which credit risk is hedged by credit derivatives, namely (1) to elect fair value through profit or loss only at initial recognition (2) to elect fair value through profit or loss at initial recognition or subsequently (if subsequently, the difference between the then carrying amount and fair value is recognised immediately in profit or loss) or (3) to elect fair value through profit or loss at initial recognition or subsequently (if subsequently, the difference between the then carrying amount and fair value is amortised (for loans) or deferred (for loan commitments).

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In principle we support that hedge accounting be permitted for credit risk as long as the hedging relationship satisfies the general hedging principles proposed in the ED and is in accordance with the risk management objectives and strategies of the entity. To reduce operational complexity we would like to propose that only one method be permitted and alternative 3 is the preferred method. This alternative minimizes accounting mismatches and would better reflect the effects of an active and flexible risk management strategy in financial reporting.

Question 16

Do you agree with the proposed transition requirements? Why or why not? If not, what changes do you recommend and why?

The Board proposed that the ED be applied prospectively and we agree with this proposal.