MASB MALAYSIAN ACCOUNTING STANDARDS BOARD
LEMBAGA PIAWAIAN PERAKAUNAN MALAYSIA

19 September 2008

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

Dear Sir David

IASB Discussion Paper: Reducing Complexity in Reporting Financial Instruments

The Malaysian Accounting Standards Board welcomes the opportunity to provide comments to the IASB on Discussion Paper Reducing Complexity in Reporting Financial Instruments.

We support IASB's initiatives to simplify reporting of financial instruments. The DP has recognised that the cause of complexity of financial instruments is that financial instruments themselves are complex, aggravated by the scores of requirements of IAS 39 that often obscure the underlying principles.

We also support IASB's approach that any changes should aim towards providing more relevant and understandable information and should result in simplification for preparers and users of financial statements.

Any long-term objective to measure financial instruments at fair value must be properly supported by adequate guidance. We believe the lack of guidance in the determination of fair value, especially in illiquid markets, is one of the major causes of complexity of reporting financial instruments. This is a particular area where the Standard should focus on.

Append below is our detailed comments to the questions raised in the DP.

If you need further clarification, please contact the undersigned at +603 2240 9200 or email at nordin@masb.org.my.

Yours sincerely,

Nordin

Dr Nordin Mohd Zain
Executive Director

IASB Discussion Paper: Reducing Complexity in Reporting Financial Instruments

Question 1

Do current requirements for reporting financial instruments, derivative instruments and similar items require significant change to meet the concerns of preparers and auditors and the needs of users of financial statements? If not, how should the IASB respond to assertions that the current requirements are too complex?

We believe the current requirements for reporting financial instruments, derivative instruments and similar items are too complex and should be simplified to meet the concerns of preparers and auditors and the needs of users of financial statements.

Question 2

(a) Should the IASB consider intermediate approaches to address complexity arising from measurement and hedge accounting? Why or why not? If you believe that the IASB should not make any intermediate changes, please answer questions 5 and 6, and the questions set out in Section 3.

Yes, we believe the IASB should make an effort to reduce complexity arising from measurement and hedge accounting in the intermediate term.

Held-to-maturity category

In view of the long term objective to measure all financial instruments at fair value, we believe the first step is to remove the held-to-maturity category (HTM) which uses the amortised cost measurement basis.

By removing the HTM category, all financial assets would be measured at fair value and it will eliminate the need to monitor the 'tainting rules' which most preparers found difficult to achieve. We believe this is a sensible intermediate step toward the full fair value model.

The removal of the HTM category will also reduce the total number of categories of financial instruments.

Available-for-sale category

We disagree with the proposal to eliminating the available-for-sale (AFS) category, mainly because of the potential volatility in earnings.

If AFS category is eliminated, an investment can only be either classified under HTM or at fair value through profit or loss (FVP). Since many investments are not intended to be and would not qualify as HTM, the only category left is FVP. As these investments, most of which were previously classified under AFS, may not be part of the trading portfolio it may not be appropriate for the fair value fluctuation to be reflected in the earnings.

We note that the IASB is currently working on the financial statements presentation project that seeks to address presentation issues with regards to earnings volatility arising from fair value changes.

Therefore, we propose that the IASB defer its decision to eliminate the AFS category and retain the existing approach to AFS until the financial statement presentation project is complete or substantially in progress.

Hedge accounting

One major complexity for hedge accounting that the Board should reduce in the intermediate term is the hedge effectiveness testing and assessment.

The strict hedge effectiveness tests have prevented some entities from applying hedge accounting even though a particular hedging transaction makes economic sense and was genuinely entered into by management for that purpose. Hence the Board should consider removing or relaxing the effectiveness assessment test to eradicate such counter intuitive outcome for financial reporting purposes in the financial statements.

(b) Do you agree with the criteria set out in paragraph 2.2? If not, what criteria would you use and why?

Yes, we agree with the criteria set out in paragraph 2.2.

Question 3

Approach 1 is to amend the existing measurement requirements. How would you suggest existing measurement requirements should be amended? How are your suggestions consistent with the criteria for any proposed intermediate changes as set out in paragraph 2.2?

As mentioned in our answer to question 2(a), we suggest the HTM category to be eliminated. The removal of HTM category is in line with paragraph 2.2(b) & (c) criteria.

Question 4

Approach 2 is to replace the existing measurement requirements with a fair value measurement principle with some optional exceptions.

(a) What restrictions would you suggest on the instruments eligible to be measured at something other than fair value? How are your suggestions consistent with the criteria set out in paragraph 2.2?

Introducing new measurement requirements at this juncture would not contribute towards reducing complexities. We prefer the intermediate solutions that would *simplify or reducing existing requirements rather than introducing new requirements. Nevertheless, we agree with the concept of 'cash flow variability' in identifying items that may not be carried at fair value, if the same concept is to be used as the long term solution.*

For financial instruments whose cash flows are not highly variable, we believe it may be appropriate to use the cost based measurement model.

All others should be measured at fair value. This would be in line with the long term objective to measure financial instruments at fair value which would result in more relevant information for users of financial statements and it will also help to simplify the measurement of non-complex financial instruments.

However, the long term objective must be supported by sufficient fair value measurement guidance. The lack of guidance in the determination of fair value, especially in illiquid markets, is one of the major causes in the complexity of reporting financial instruments.

(b) How should instruments that are not measured at fair value be measured?

Financial instruments, other than those whose cash flows are not highly variable, should be measured at cost, amortised or accreted cost subject to impairment test.

(c) When should impairment losses be recognised and how should the amount of impairment losses be measured?

The impairment assessment criteria and impairment measurement basis in IAS 39 should be used. Introducing new impairment assessment method may introduce new complexities.

(d) Where should unrealised gains and losses be recognised on instruments measured at fair value? Why? How are your suggestions consistent with the criteria set out in paragraph 2.2?

The recognition of unrealised gains and losses on instruments measured at fair value would depend on the nature (ie operating, investing or financing) of the financial instruments held and the categories of the financial instruments. This would provide more relevant information and more easily understandable information for users of financial statements.

Therefore, the decision would depend on the outcome of the financial statement presentation project currently in progress.

(e) Should reclassifications be permitted? What types of reclassifications should be permitted and how should they be accounted for? How are your suggestions consistent with the criteria set out in paragraph 2.2?

Although theoretically we believe reclassifications should not be permitted, it may not be workable in practice. Management intent and purpose may change *depending on the economic environment and the resultant effect should then be reflected in the financial statements. To prohibit reclassifications would not provide more relevant information and more easily understandable information for users of financial statements.*

Question 5

Approach 3 sets out the possible simplifications of hedge accounting.

(a) Should hedge accounting be eliminated? Why or why not?

Hedge accounting should not be removed in the immediate term especially with regards to hedged items that are not financial instruments. To do so would result in mismatch which may give a counter intuitive outcome to the financial statements

(b) Should fair value hedge accounting be replaced? Approach 3 sets out three possible approaches to replacing fair value hedge accounting.

No, we do not believe fair value hedge accounting should be replaced or eliminated for the reason mentioned in question 5(a). Also, introduction of any of the second and third approaches would introduce new and/or revised requirements which may not reduce the current complexities. Generally, we believe any intermediate approaches for reducing complexities should either simplify or eliminate existing requirements rather than introducing new requirements.

(i) Which method(s) should the IASB consider, and why?

For the reason stated in our reply to question 5(b) above, we do not believe the three possible approaches proposed would reduce the current complexities.

(ii) Are there any other methods not discussed that should be considered by the IASB? If so, what are they and how are they consistent with the criteria set out in paragraph 2.2? If you suggest changing measurement requirements under approach 1 or approach 2, please ensure that your comments are consistent with your suggested approach to changing measurement requirements.

We do not have other comments.

Question 6

Section 2 also discusses how the existing hedge accounting models might be simplified. At present, there are several restrictions in the existing hedge accounting models to maintain discipline over when a hedging relationship can qualify for hedge accounting and how the application of the hedge accounting models affects earnings. This section also explains why those restrictions are required.

(a) What suggestions would you make to the IASB regarding how the existing hedge accounting models could be simplified?

Please refer to question 2(a).

(b) Would your suggestions include restrictions that exist today? If not, why are those restrictions unnecessary?

Yes. The existing stringent requirements relating to hedge effectiveness tests have prevented reporting entities to apply hedge accounting on many genuine economic hedge transactions. Thus, we believe those requirements should be relaxed, to be supplemented with sufficient disclosures on the methods used by the reporting entities in testing hedge effectiveness.

(c) Existing hedge accounting requirements could be simplified if partial hedges were not permitted. Should partial hedges be permitted and, if so, why? Please also explain why you believe the benefits of allowing partial hedges justify the complexity.

Although partial hedges increase complexity associated with hedge accounting, we believe it should not be eliminated. To do so would result in mismatch which may give a counter intuitive outcome to the financial statements. It is common for certain reporting entities to hedge and mitigate designated risks down to the extent tolerable for risk management purposes, which in some cases represent partial risks faced.

(d) What other comments or suggestions do you have with regard to how hedge accounting might be simplified while maintaining discipline over when a hedging relationship can qualify for hedge accounting and how the application of the hedge accounting models affects earnings?.

We believe to only require qualitative prospective test for applying hedge accounting would contribute towards reducing the current complexities. As quantitative retrospective test would still be required, this would ensure only sufficiently effective hedging transactions would be reflected as such in the financial statements.

Question 7

Do you have any other intermediate approaches for the IASB to consider other than those set out in Section 2? If so, what are they and why should the IASB consider them?

We do not have other comments.

Question 8

To reduce today's measurement-related problems, Section 3 suggests that the long-term solution is to use a single method to measure all types of financial instruments within the scope of a standard for financial instruments.

Do you believe that using a single method to measure all types of financial instruments within the scope of a standard for financial instruments is appropriate? Why or why not? If you do not believe that all types of financial instruments should be measured using only one method in the long term, is there another approach to address measurement-related problems in the long term? If so, what is it?

We agree to the use of a single method to measure all financial instruments. However, for the sole purpose of reflecting business intuits and substance, we think modification or exception from the single measurement method should be provided for certain specified transactions and circumstances. Two of these possible circumstances are discussed below in our replies to Questions 9 and 10.

Question 9

Part A of Section 3 suggests that fair value seems to be the only measurement attribute that is appropriate for all types of financial instruments within the scope of a standard for financial instruments.

(a) Do you believe that fair value is the only measurement attribute that is appropriate for all types of financial instruments within the scope of a standard for financial instruments?

(b) If not, what measurement attribute other than fair value is appropriate for all types of financial instruments within the scope of a standard for financial instruments? Why do you think that measurement attribute is appropriate for all types of financial instruments within the scope of a standard for financial instruments? Does that measurement attribute reduce today's measurement-related complexity and provide users with information that is necessary to assess the cash flow prospects for all types of financial instruments?

We agree that fair value is the suitable measurement method for all financial instruments. However, the application of full fair value for all instruments should not be required until sufficient and acceptable guidelines for measuring fair values for each type of financial instruments are available.

We believe that integrity of fair value information is paramount for the users of financial statements. We reckon that existing market practices for determining fair value may not be sufficiently mature or established to the perceived level required for certain financial instruments and/or certain financial market segments. Thus, appropriate 'qualifying' criteria may be required to allow for financial instruments to be carried at fair value.

Accordingly, the second method of carrying these 'non-qualifying' financial instruments at cost/amortised cost/accreted cost may still be required.

Question 10

Part B of Section 3 sets out concerns about fair value measurement of financial instruments. Are there any significant concerns about fair value measurement of financial instruments other than those identified in Section 3? If so, what are they and why are they matters for concern?

While we believe the supporting reasons for carrying own non-trading financial liabilities at fair value are valid for situations where the reporting entity could repurchase its financial liabilities, it should not be the case for other situations.

In many situations the reporting entity as the issuer is able and intends to repay the full obligatory amounts of the liabilities. The fair value fluctuation of the financial liabilities in those situations merely represents the changes in the risk premium imposed by the investors if the instruments are to be transferred as at a particular date (before the maturity of the said instruments). Even in situations when it is likely that the issuer would not be able to honour its obligations fully, the fluctuation in the price of the instruments may not represent the 'hair-cut' that would be given by the creditors or the 'actual gain' that would be realised by the issuer.

Therefore, other than the situation mentioned in the first sentence above, we do not believe fair value is the appropriate measurement method for non-trading financial liabilities.

Question 11

Part C of Section 3 identifies four issues that the IASB needs to resolve before proposing fair value measurement as a general requirement for all types of financial instruments within the scope of a standard for financial instruments.

(a) Are there other issues that you believe the IASB should address before proposing a general fair value measurement requirement for financial instruments? If so, what are they? How should the IASB address them?

(b) Are there any issues identified in part C of Section 3 that do not have to be resolved before proposing a general fair value measurement requirement? If so, what are they and why do they not need to be resolved before proposing fair value as a general measurement requirement?

For the reason stated in our reply for Question 9 above, appropriate 'qualifying' criteria may be required for allowing financial instruments to be carried at fair value.

Question 12

Do you have any other comments for the IASB on how it could improve and simplify the accounting for financial instruments?

We do not have other comments.