



4 September 2008

International Accounting Standards Board
1st Floor 30 Cannon Street
London EC4M 6XH
United Kingdom

(By email: commentletters@iasb.org)

Dear Sir,

RESPONSE TO DISCUSSION PAPER ON REDUCING COMPLEXITY IN REPORTING FINANCIAL INSTRUMENTS

The Accounting Standards Council appreciates the opportunity to comment on the discussion paper on **Reducing Complexity in Reporting Financial Instruments** issued by the International Accounting Standards Board in March 2008. Our comments below address the specific questions set out in the Discussion Paper.

Section 1 Problems related to measurement

Question 1

Do current requirements for reporting financial instruments, derivative instruments and similar items require significant change to meet the concerns of preparers and their 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?

2. We are of the view that the current requirements for reporting financial instruments, derivative instruments and similar items require changes to meet the concerns of preparers and their auditors and the needs of users of financial statements. We note that many Singapore constituents have expressed that IAS 39 is complex to apply and, in illiquid market conditions, may distort the real economic substance of the financial state of affairs.

3. The current IAS 39 is rules-based which creates the complexity in reporting financial instruments. Accordingly, to reduce the complexity in reporting financial instruments, it is necessary for the IASB to develop a principles-based IFRS to report financial instruments. The introduction of a principles-based IFRS to report financial instruments would potentially reduce the number of financial instrument classifications within IAS 39 and simplify the conditions for hedge accounting.

Section 2 Intermediate approaches to measurement and related problems

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.

4. The IASB should consider intermediate approaches only if it makes meaningful progress towards the final goal of reducing complexity in reporting financial instruments. We agree with paragraph 2.2(d) of the discussion paper that any proposed intermediate change must offer improvement and simplification that is significant enough to justify the cost of the change. This is because though the current requirements in IAS 39 are complex, they nonetheless have been applied by constituents both in Singapore and globally for a sufficient period of time and any intermediate change of measurement approaches which is not the final position would potentially confuse preparers and users of financial statements.

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

5. We agree with the criteria set out in paragraph 2.2 except for paragraph 2.2(b). We question the relevance of paragraph 2.2(b) when the subject matter of a long-term measurement objective is itself a subject for discussion in Section 3 of the discussion paper and it would appear strange at this juncture to hinge any proposed intermediate change on a criterion that is not yet clear.

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?

6. We are of the view that the current existence of the four measurement categories in IAS 39 introduces complexity in reporting financial instruments and as outlined in our response to question 2(a), any proposed intermediate change must offer improvement and simplification that is significant enough to justify the cost of the change.

7. We recommend that the “tainting” rules for the Held-to-Maturity (HTM) category be eliminated as this is a current source of complexity in IAS 39. Though we agree that rules are needed for anti-abuse purposes but appropriate disclosure requirements can equally prevent entities from opportunistically transferring financial instruments between categories in order to achieve certain accounting outcomes as these transfers would have to be disclosed nonetheless by the entities. This would give entities more flexibility in deciding

whether to reclassify or dispose before maturity the financial instruments in the HTM category without having to deal with the complex tainting rules.

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?

8. We do not have any suggestions to this question.

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

9. They should be measured at amortised cost subject to impairment.

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

10. We note that the IASB has stated in paragraph 1.10 of the discussion paper that complexity could be reduced in not having to identify and quantify impairment when fair value is used. Conceptually, we agree with this view. However, we are of the view that any intermediate proposed change in measuring impairment losses has to be addressed by the IASB holistically with regard to the measurement framework for financial instruments and not in isolation.

(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?

11. Unrealised gains and losses arising from financial instruments measured at fair value should be recognised based on the category that the financial instrument falls under.

(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?

12. Other than our response to question 3 on the Held-to-Maturity (HTM) category where we suggested the removal of the tainting rules so as not to trigger off reclassification of financial instruments in the HTM category, we would take this opportunity to surface a concern from a constituent from the Singapore banking sector on this issue of reclassifications of financial instruments.

13. It must be recognised that in many banks, the “trading unit” and the “investment unit” are separate departments. On occasions, the trading unit may decide that a financial instrument it currently holds does not fit its overall strategy while the investment unit may be interested in holding on to such a position. In such instances, permitting transfers within portfolios will be reasonable and also lowers the entity’s transaction costs.

14. In addition, the issue of whether reclassifications should be permitted would not arise if a categorisation approach hinges on facts and circumstances. For instance, if an entity purchase a bond, which it classify as HTM. As the bond was quoted in an active market at the time of purchase, it could not be classified under Loans and Receivables. In the event that there is no longer an active market for the bond subsequently, the entity should be allowed to reclassify this investment to “Loans and Receivables”.

Question 5

Approach 3 sets out possible simplifications of hedge accounting.

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

15. We are of the view that hedge accounting should not be eliminated as this would not allow the entities to reduce the measurement mismatches caused by measuring hedging instruments at fair value and measuring hedged items in a different way. Moreover, as a hedge is taken out specifically for business needs to cancel or reduce risks and as such, hedge accounting should not be eliminated as it simply reflects the economics of business.

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

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

16. We are of the view that fair value hedge accounting should not be replaced as this would not potentially reduce complexity in reporting financial instruments and any of the 3 approaches may potentially introduce a net set of complexities in the intermediate term before the introduction of a long-term solution for reporting financial instruments.

(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 your comments are consistent with your suggested approach to changing measurement requirements.

17. We do not have any other methods to surface that should be considered by the IASB.

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?

18. We are of the view that from a designation angle, entities should be allowed to set a general policy for effectiveness testing that would include a fallback position if the initially documented method turns out to be in error. Entities can have several effectiveness testing methodologies to cater for different groups of hedging instruments and hedged items. This will also greatly simplify the documentation process.

19. We disagree with the irrevocable designation suggested in the discussion paper as it is inflexible. The method might potentially reduce accounting complexities but it is not aligned with economic substance and reality.

20. We would take this opportunity to surface a concern from a Singapore constituent with regard to the cash flow hedging of its foreign exchange risks in respect of its long term transactions. Though a cash flow hedge achieves a match between the hedged item and hedging instrument in the income statement, it does not remove the balance sheet mismatch when cash flow hedges are used for hedges of future transactions (i.e. sales or purchases etc.) which are highly probable forecast transactions.

21. When the effective part of the gains or losses on the derivative financial instrument is recognised directly in equity, this would have an impact on the net asset value of the entity as the corresponding gain or loss on the hedged item representing a highly probable forecast transaction is not recognised. In the event when there is a fair value loss on the hedging instrument for a highly probable forecast transaction, this would give rise to a hedge reserve deficit balance resulting in a “depressed” net asset value of the entity. Similarly, a fair value gain on the hedging instrument would result in an “inflated” net asset value of the entity.

22. The concern is that the resulting hedging reserve balance may not convey a reflective position of the entity’s performance to the users of the entity’s financial statements especially in the event when it is negative. Users of the entity’s financial statements may question the existence of a negative hedging reserve given the fact that hedging is supposed to mitigate the economic risks of the entity’s performance.

23. Whilst we are not suggesting that gains or losses on the hedged items representing highly probable forecast transactions to be recognised in tandem with the gains or losses on

the hedging instruments as this would not be conceptually defensible, we recommend that the IASB reexamine this area of cash flow hedge accounting in light of the fact that one of the objectives of hedge accounting is to remove accounting mismatches in the financial statements. However, any proposed change in cash flow hedge accounting should not add complexity and should be aligned with the long term aim of developing a principles-based IFRS for hedge accounting.

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

24. The suggestions include the restrictions that exist today.

(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.

25. Yes, partial hedges should be allowed as it is reflective of the underlying economics i.e. how the entity hedges its risks. We are of the view that the IASB should not disallow partial hedging due to complexity and difficulty for users to understand it. Financial instruments that cater for full hedging of risks may not always be available, for example, a swap of a particularly long tenor. Moreover, full hedges may be expensive. Furthermore, certain hedges take into account tax impact, i.e. some financial instruments are hedged on a post-tax as opposed to pre-tax basis.

(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?

26. We do not have other comments.

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?

27. We do not have any other intermediate approaches for the IASB to consider.

Section 3 A long-term solution-a single measurement method for all types of financial instruments

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?

28. We disagree with the long-term solution of using a single method (i.e. fair value) to measure all types of financial instruments for the following reasons:

Objective of financial reporting

29. The objective of financial reporting is to assist users to make economic decisions, taking into account their assessment of the entity's performance, financial position and cash flow generation capacity. This objective can only be achieved if information provided is, from the users' perspective, relevant, reliable, understandable, comparable and most importantly, reflective of the underlying economics.

30. Using a single measurement method (i.e. fair value) may seem to improve comparability across entities, but in reality it does not. It introduces more subjectivity as fair value measurement requires judgment. Depending on the assumptions used, the fair value calculated for the same financial instrument may differ across entities. The absence of consistent methodologies to measure all financial instruments at fair value will compromise the relevance, reliability and comparability of financial statements. It also raises the question of what, in reality constitutes "fair value".

31. It is incorrect to assume that all users have the same information needs and will prefer a single measurement method. They will want to know which are the investments undertaken for trading purposes and which are those that are held to maturity to generate cash flows. Financial reporting is a communication tool for management to report the performance of the entity to shareholders and must reflect the entity's business model. Fair valuing all financial instruments will not reflect the nature of different classes of financial assets and liabilities and the substance of transactions undertaken by the entity. Recognition of unrealised gains and losses in an entity's income statement is only meaningful if there is intent to realise them in the short term.

32. In addition, the recent credit crisis has demonstrated that market values can be significantly affected by an imbalance of supply and demand. If entities do not intend to close out positions at current market values, then using market values could be misleading and causes significant profit and loss volatility. Users will find it more difficult to interpret the financial statements in such situations. Applying fair value to all financial instruments is akin to “assessing” what could be realised at a “point in time” and contradicts the “going concern” principle.

A full fair value model may not reduce complexity

33. Instead of reducing complexity, a single measurement method (i.e. fair value) may increase complexity. Entities may have to spend significant resources on improving systems in order to cater for this change. There are many financial instruments which are not actively traded. Valuation models are required to value these financial instruments, which may lead to profit or loss volatility. We would also take this opportunity to highlight the view of a constituent from the Singapore banking sector which is that it does not make economic sense for banks to fair value all their commercial loans (especially performing ones) at every reporting date, when these unrealised gains or losses are unlikely to be realised by the banks in the future.

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?

34. We are of the view that fair value measurement is only appropriate for financial instruments held for trading purposes or otherwise managed on a fair value basis. A mixed measurement model, as opposed to a full fair value model, will provide users of financial statements with more relevant, reliable, understandable and comparable information.

Whilst the current measurement method may be imperfect, it is less distorted. This model is presently well established and understood by users of financial statements and is largely able to reflect the commercial substance underlying different business models. Users of financial statements, such as financial analysts, should have already developed robust processes to analyse an entity’s financial statements based on this mixed measurement

model. In addition, supplementary fair value disclosures are already required for financial instruments not measured at fair value. These disclosures can be kept to provide added perspectives for users of financial statements.

35. Furthermore, the question of whether fair value is the only measurement attribute that is appropriate for all types of financial instruments should not be considered in isolation with regard to a single standard for financial instruments. We are of the view that the IASB should consider this question more holistically within the measurement phase of the conceptual framework project.

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?

36. We would like to take this opportunity to surface to the IASB a significant concern expressed by a constituent from the Singapore banking sector on the requirement for entities to consider the effect of their own credit risk when fair valuing their financial liabilities, which is the point made in paragraph 3.75 of the discussion paper.

37. When an entity's credit risk deteriorates, a gain is reflected in the income statement. This is counter-intuitive as it does not make commercial sense to report a gain when an entity is encountering financial difficulties and a loss when the creditworthiness of an entity improves. Most users of financial statements may not be able to understand this "gain" and thus the objective of providing understandable information to users of financial statements may not be met.

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?

38. We do not have any comments on this question.

Question 12

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

39. We have no further comments.

40. Should you require any further clarification, please kindly contact me. Thank you.

Yours faithfully,

Dexter Tan
Secretary, Accounting Standards Council