Australian Government
Australian Accounting Standards Board

Staff paper

Project:	**Public Sector Long-term Discount and Inflation Rates**	**Meeting:**	March 2023 (M194)
Topic:	Draft project plan	**Agenda item:**	6.1
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		Project priority	Medium
		Decision-making	Low
		Project status	Initial project planning

Objective of this agenda item

1 The objective of this item is for the Board to **consider** a project plan for the Public Sector Long-term Discount and Inflation Rates project.

2 It is planned that the project consider issues around requirements in existing Accounting Standards for present valuing future cash flows in a public sector context. The project may lead to public-sector specific guidance or modifications. It is not intended to lead to the development of new requirements to either extend or limit the application of present value accounting.

Background and reasons for bringing this item to the Board

3 The Feedback Statement on Agenda Consultation 2022-2026 notes that:

> In June 2022, the Board considered its responses to the feedback received on ITC 46 and decided to: …
>
> - retain the public sector long-term discount rates project in the work program; … [page 11]

4 The Feedback Statement also notes that the standard-setting project:

- is of high importance and medium urgency [page 12]; and
- has an expected 18-month timeline from Q1 2023 [page 13].

5 The IASB most recently ended any fundamental work on discount rates in 2019. It has various current IASB projects that touch on aspects of discount rates, including:

- the post-implementation review of classification and measurement under IFRS 9 *Financial Instruments*, in terms of presenting the impacts of changes in own credit risk; and
- targeted improvements to IAS 37 *Provisions, Contingent Liabilities and Contingent Assets*, including whether non-performance risk should be included in determining discount rates.

However, the IASB nor the IPSASB are currently working on any broad-ranging matters relating to present valuing future cash flows.

6 Existing Standards that include requirements for measures based on the present value of future cash flows include:

(a) AASB 16 *Leases*

(b) AASB 17 *Insurance Contracts*

(c) AASB 119 *Employee Benefits*

(d) AASB 136 *Impairment of Assets*

(e) AASB 137 *Provisions, Contingent Liabilities and Contingent Assets*.

7 Other Standards that can also involve measures based on the present value of future cash flows, include:

(a) AASB 9 *Financial Instruments*

(b) AASB 13 *Fair Value Measurement*

(c) AASB 15 *Revenue from Contracts with Customers*

(d) AASB 116 *Property Plant and Equipment*

(e) AASB 141 *Agriculture*.

8 Staff consider that before undertaking any standard-setting activities regarding long-term discount rates, work is needed to gain a comprehensive understanding of:

(a) the objectives of discounting and inflating of cash flows under Accounting Standards; and

(b) the issues and concerns with the existing discounting/inflating requirements in a public sector context.

9 Accordingly, staff are asking the Board to consider a draft project plan (outlined in paragraphs 13–21 below) to approve the general conduct of activities needed for the project.

Issues raised by stakeholders

10 In relation to long term discount rates, Invitation to Comment 46 *Agenda Consultation 2022-2026* [ITC 46] noted that:

> AASB 119 *Employee Benefits* requires NFP public sector entities to use market yields on government bonds to discount their post-employment benefit obligations. In July 2015, the AASB noted a letter from the Heads of Treasuries Accounting and Reporting Advisory Committee (HoTARAC) expressing concern about using a spot discount rate for their defined benefit obligations. The primary concern was that the spot rate was volatile. Given the magnitude of defined benefit obligations in the public sector, significant volatility in the entity's profit or loss may occur. Furthermore, using a spot rate does not reflect how these entities manage their defined benefit liabilities. Constituents, including HoTARAC, requested that the AASB consider alternative discount rates that would more accurately reflect how public sector entities manage their defined benefit liabilities. Among the options suggested was an average, or long-term, rate to help reduce volatility. Whatever the chosen rate might be, it would be beneficial if

that rate could be consistent (or be made consistent) with other long-term liability discounting requirements. Further, as a result of feedback received from the ITC 34 *AASB Agenda Consultation 2017-2019*, the Board decided at the May 2017 meeting to conduct preliminary research on long-term discount rates and the impact of the volatility of spot discount rates on defined benefit liabilities of the public sector. However, there has been limited progress on this project due to the impact of other priorities of the Board. [page 12]

11 Public sector stakeholders raised similar concerns in the course of conducting work on the application of AASB 17 *Insurance Contracts* to public sector entities in respect of measuring liabilities for incurred claims, including issues and concerns about:

(a) identifying risk free discount rates;

(b) identifying relevant inflation rates;

(c) different views on whether liquidity is a relevant consideration in formulating discount rates for public sector entities;

(d) different views on whether credit risk is a relevant consideration in formulating discount rates relating to the measurement of assets and/or liabilities for public sector entities;

(e) inconsistencies between discount rates required in different Standards;[1]

(f) the volatility in reported amounts that can arise from changes in discount rates, which potentially distracts from a relevant depiction of performance;

(g) a general lack of focus on the potential impacts of inflation; and

(h) presentation and disclosure of the impacts of changes in discount/inflation rates.

12 In finalising the public sector modifications to AASB 17, the Board noted the following (**emphasis added**).

> BC297 **The Boards decided that they would not propose any modifications on discounting fulfilment cash flows for the following reasons**.
>
> (a) The same discounting issues which arise for public sector entities also arise for private sector entities, while acknowledging those issues can have a more significant impact for public sector entities.
>
> (b) **The issues of volatility of liabilities due to discount rate changes from period to period are also a feature of the discount rate requirements in other Standards** (such as AASB 119/PBE IPSAS 39 Employee Benefits), and that any efforts to address these issues would need to involve a broad-based project that goes beyond a project on insurance arrangements in the public sector.
>
> (c) **Any project on discount rates might involve a broader consideration of measurement issues more generally**.

1 For example, AASB 17 and AASB 137 *Provisions, Contingent Liabilities and Contingent Assets* have differently-worded discount rate requirements and, due to the scope criteria included in AASB 17, some public sector entities may be shifting from one Standard to the other in 2026.

BC298 Specifically in relation to the possible application of long-run investment returns as the basis for discount rates, the Boards noted that, conventionally, assets and liabilities are measured independently. That is, for example, the measurement of a liability is based on the liability's inherent characteristics, not on the characteristics of any assets that might be available to settle the liability. Accordingly, **the Boards concluded that any consideration of overturning long-standing conventions of this nature would need to involve a review of principles that go beyond a project on insurance arrangements in the public sector**.

Overall approach to the project

13 The proposed overall approach to the project is to commence with an issues development phase, followed by a standard-setting response as needed.

14 Unlike a research project that typically involves identifying whether there are possible accounting problems to be resolved, the issues development phase is designed to be more targeted. In the case of public sector long-term discount and inflation rates, concerns have already been identified, and we need to fully understand them and determine a possible standard-setting response that is measured and appropriate.

Issues development phase

15 The objective of the issues development phase is to identify any possible improvements to existing requirements in Australian Accounting Standards that involve the use of measurements based on the present value of future cash flows, which may be discounted/inflated.

16 In this context, the project will examine issues and concerns raised by public sector stakeholders, as noted in response to agenda consultation.

17 The planned approach to the issues development phase of the project includes the following activities:

(a) identifying and clearly articulating the objectives of discounting and inflating of cash flows under Accounting Standards;

(b) outlining the techniques applied in practice to meet the requirements, including current public-sector-specific guidance provided on the techniques and rates to apply in specific circumstances;

(c) gain a comprehensive understanding of the issues and concerns with the existing discounting/inflating requirements in a public sector context;

(d) identify ideas for resolving issues and concerns and a recommended standard-setting response, including whether there are any public-sector-specific matters that might justify modifications to Standards; and

(e) an analysis of possible alternative approaches to discounting and inflating in terms of recognition, measurement, presentation and disclosure.

18 The planned information gathering approach to the issues development phase of the project includes the following activities:

(a) stakeholder outreach (the likely candidates for outreach are noted in Appendix A to this paper); and

(b) a literature review focused on financial reporting and finance literature and actuarial literature.[2]

19 The final product of the issues development phase is the publication of a report[3] that would include:

(a) one or more recommendations for the Board's consideration, which may include: proposed amendments to discounting/inflating requirements, additional public sector guidance, or issuing an agenda decision, which may explain that no action is to be taken; and

(b) evidence and reasoning supporting the recommendation(s).

Planned timeline

20 The following is the tentative timeline for the issues development phase of the project.

	March 2023	***Q2 2023***	***Q3 2023***	***Q4 2023***	***Q1 2024***
Project plan agreed					
Analysing requirements in Standards and their application					
Stakeholder outreach					
Literature review					
Analysis of results					
Board to decide on the relevant standard-setting response			Progress	Progress	Final

21 The following table outlines further indicative timing based on three possible standard-setting responses.

2 In collaboration with the AASB Research Centre.

3 This may, for example, take the form of a project higlights paper or update.

Possible standard-setting responses	***H1 2024***	***H2 2024***	***H1 2025***	***H2 2025***	***H1 2026***	***H2 2026***
Agenda decision, which may explain no action	Agenda decision					
Minor proposed amendments, e.g. public-sector-specific guidance		ED		Final Standard		
Major proposed changes specific to public sector			ED	ED		Final Standard

Question for Board members:

Q1: Do Board members have comments on the planned approach to the issues development phase of the project outlined in paragraphs 15–19, including the stakeholder outreach plan in Appendix A?

Appendix A: Stakeholder outreach

22 Staff aim to conduct interviews with key Australian stakeholders, including the following:

(a) Treasuries and/or Departments of Finance in each of the states and territories and the Commonwealth;

(b) Auditors General Offices in each of the states and territories and the Commonwealth;

(c) a selection of agencies that are particularly affected by present value measures;

(d) government actuaries and actuarial consultants used by governments;

(e) academics who have a history of researching the topic; and

(f) ratings agencies.

23 Staff also aim to conduct interviews with a number of key overseas stakeholders, including:

(a) relevant New Zealand stakeholders; and

(b) stakeholders associated with the International Public Sector Accounting Standards Board.

24 Interview matters for discussion are expected to include the following:

(a) the manner in which discount rates and inflation rates are currently determined for financial reporting purposes;

(b) any existing public-sector-specific guidance, formal or informal, for applying the discounting and inflating requirements for financial reporting purposes;

(c) how volatility resulting from changes in discount rates and inflation rates is managed and explained to readers of the financial statements;

(d) views on whether there are public-sector-specific factors relating to discount rates and inflation rates that could be the basis for having modified requirements relative to the private sector;

(e) whether rates used in financial reporting could benefit from considering rates used in cost-benefit analyses, including business case analyses; and

(f) presentation formats that may help explain the impacts of changes in discount rates and inflation rates.