ABS (PL) Pty Ltd ... providing ... Actuarial Benefit Services

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The Chairman
Australian Accounting Standards Board
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Dear Chairman

ED187 – Discount Rate for Employee Benefits AASB119

Thank you for the opportunity to comment on proposed changes to AASB119. My views reflect my position as an actuary who performs valuations for small and medium entities.

Previous IASB Conclusions

I note that in the document titled "*International Accounting Standard IAS 19- Employee Benefits - January 2008 (incorporating amendments from IFRSs issued up to 17 January 2008) - BASIS FOR CONCLUSIONS*". The IASB stated in BC31

> "The Board has not identified clear evidence that the expected return on an appropriate portfolio of assets provides a relevant and reliable indication of the risks associated with a defined benefit obligation, or that such a rate can be determined with reasonable objectivity. Therefore, the Board decided that the discount rate should reflect the time value of money but should not attempt to capture those risks. Furthermore, the discount rate should not reflect the entity's own credit rating, as otherwise an entity with a lower credit rating would recognise a smaller liability. The rate that best achieves these objectives is the yield on high quality corporate bonds. In countries where there is no deep market in such bonds, the yield on government bonds should be used."

However, in the Introduction to this international ED, the IASB states:

> "Introduction: IAS 19 Employee Benefits requires an entity to determine the rate used to discount employee benefit obligations with reference to market yields on high quality corporate bonds at the end of the reporting period. However, when there is no deep market in such bonds, IAS 19 requires an entity to use market yields on government bonds instead. The use of these different rates means that entities with similar employee benefit obligations can report them at very different amounts. The significant widening of the spread between yields on corporate bonds and yields on government bonds as a result of the global financial crisis has considerably increased this effect."

Comment: It seems that these two "basis for changes" are at odds. It appears that the significant widening of the gap between government and corporate bond yields as a result of the GFC, is because of the increased relative riskiest of high quality corporate bonds compared to government bonds (ie or, the increase in corporate yields corresponds to an (implicit) lower credit rating due to future uncertainty of corporate returns.)

Comment: If the objective of the IASB is to improve consistency between all entities, then the change should be to require all entities to use the government bond rate, whether or not there exists a suitably deep and liquid market in corporate bonds. Using government bond yields (or often referred to as the risk free rate) would avoid all components risk. Using corporate bond yields as a starting point still includes a component of "risk". It may better to allow specifically for this risk (and other risks) elsewhere.

Australian Version

AUS78.1 in an earlier version of AASB119 (1 January 2005) stated that Australia does not have a sufficiently active and liquid market for high quality bonds:

> "Aus78.1 In applying the requirement in paragraph 78, Australia does not have a sufficiently active and liquid market for high quality corporate bonds. Accordingly, market yields on government bonds shall be used to discount post-employment benefit obligations denominated in Australian currency."

Although the current version of AASB119 (1 January 2007) varied Aus78.1 to refer only to not-for-profit entities, paragraph 78 still included:

> "78. .... In countries where there is no deep market in such bonds, the market yields (at the reporting date) on government bonds shall be used. The currency and term of the corporate bonds or government bonds shall be consistent with the currency and estimated term of the post-employment benefit obligations."

Comment: In my experience valuing long term employee benefits in Australia, the most common interpretation was that Australia did not have a sufficiently active and liquid market for high quality corporate bonds, and as such, the government bond rate was used in most cases. The government bond rate is:

1. Publicly available
2. Accessible at the valuation date
3. Not subjective (except perhaps for durations longer than 10 years)

Comment: Based on my experience, moving from using the Commonwealth Government bond rate to using the rates reflected in "high quality corporate bonds" will introduce greater subjectivity and therefore greater disparity between entities, which seems at odds with the stated reasons for the change.

Comment: If the proposed changes are adopted in Australia then the AASB should:

1. Define what "high quality corporate bonds" means in Australia. [Note here that, the GFC has caused some "high quality corporate entities" to possibly lose their standing of high quality? How would these changes to what may be defined "high quality" be reflected in the yields adopted from period to period?]
2. Declare whether it considers Australia has an appropriate market for high quality bonds. (So that at least this presumption is consistent across valuers.)

3. Provide guidance as to where public information can be obtained efficiently at each valuation date, so that the subjectiveness of the assessments of the adopted discount rates can be reduced.

Answers to Specific IASB Questions

Question 1: Do not support the proposed change to eliminate government bonds. Change should be to require the use of government bonds for all entities, and possibly include a proviso which gives an entity the option to value at other (higher) rates with sufficient justification and quantitatively disclosing the difference in the notes to the financial statements.

Question 2: Still leaves room for greater subjectivity in cases where there is no deep market in high quality corporate bonds.

Question 3: No strong opinion on this issue. It is simply a change in assumption and should be treated consistent with any other change in actuarial assumption.

AASB Specific Matters for Comment

Question 1: In Australia, it is my experience that government bonds rates are the most common basis for the discount rate under AASB119 and therefore there may already be a significant level of consistency in Australia. (A survey of large accounting firms' experiences could provide more accurate data on this assertion.)

Question 2: Some issues specific to the Australian environment were discussed previously on Page 2. In Australia, moving to a discount rate based on "high quality corporate bonds" would likely:

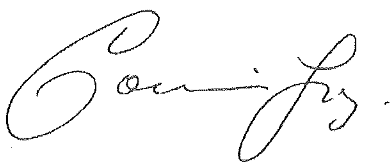
1. lead to a reduced liability in most cases (where corporate bond yields are greater than the risk-free government bond yields)

2. lead to greater subjectivity (and therefore greater variability) in discount rate between entities

3. could lead to greater pressure on valuers to use a "higher" discount rate, since objective, market data less available, which increases scope for "judgement"

Please feel free to forward this submission to the IASB if deemed suitable.

Sincerely



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