ED187 sub 4

New South Wales
TREASURY

Mr Kevin Stevenson
Chairman
Australian Accounting Standards Board
PO Box 204
COLLINS ST WEST VIC 8007

Contact: D.. McHugh
Telephone: (02) 9228 5340
Our Reference:
Your Reference:

14 September 2009

Dear Mr Stevenson

AASB ED 187 / IASB ED 2009/10 Discount Rate for Employee Benefits

The New South Wales Treasury welcomes the opportunity to provide comments to the Australian Accounting Standards Board (AASB) on Exposure Draft AASB 187 *Discount Rate for Employee Benefits*. Detailed comments to the International Accounting Standards Board (IASB) on the equivalent IASB ED 2009/10 are attached.

NSW Treasury does not support the proposal to omit reference to the government bond rate in AASB 119 / IAS 19, and instead believes that reference should be omitted to the high quality corporate bond rate.

NSW Treasury agrees that, in principle, the IASB should come up with a consistent discount rate. However, we do not believe that the high quality corporate bond rate is the relevant rate, as this is inconsistent with the existing principles in IAS 19, which is based on the time value of money, excluding actuarial, investment or entity specific credit risk. The discount rate that is most consistent with this principle is the government bond rate, as the best indicator of the risk free rate in most countries.

Notwithstanding this, we believe that if the IASB's proposal proceeds and high quality corporate bond rates are adopted, then this should be applied by the AASB to *all* entities, as there is no justification for any differential treatment for not-for-profit public sector entities. The only argument for a different treatment is based on the different credit risk of the public sector compared to the private sector. Under the existing Standard, however, this is not a valid reason for any difference in the discount rate, as para 79 explicitly excludes the consideration of entity specific risk in determining the discount rate.

If the AASB does not apply the high quality corporate bond rate to *all* entities, assuming the IASB proposal proceeds, this will result in a perverse outcome, whereby the public sector will recognise higher unfunded liabilities than the private sector, solely because the government bond rate is lower than the high quality corporate bond rate, even where in all other respects the liability may be identical. Therefore, this approach would increase inconsistency within Australia.

In the longer term, NSW Treasury shares the views of the Heads of Treasuries (HoTs) that improvements could be made to the requirements in Aus78.1 as HoTs noted in its letter dated 4 August 2009.

NSW Treasury is not aware of any regulatory impediments to implementation of the changes. We offer no comment about whether the changes are in the best interests of the Australian economy.

If you have any queries regarding NSW Treasury's comments, please contact me on 02 9228 3019 or Dianne McHugh on 02 9228 5340.

Yours faithfully

R Williams

Robert Williams
for Secretary

New South Wales
TREASURY

Sir David Tweedie
Chairman
International Accounting Standards Board
30 Cannon St
London EC4M 6XH
United Kingdom

Contact: D., McHugh
Telephone: (02) 9228 5340
Our Reference:
Your Reference:

14 September 2009

Dear Sir David

ED 2009/10 Discount Rate for Employee Benefits

New South Wales Treasury welcomes the opportunity to provide comments to the International Accounting Standards Board (IASB) on the Exposure Draft: *Discount Rate for Employee Benefits*. Detailed comments are attached.

NSW Treasury does not support the proposal to omit reference to the government bond rate in IAS 19, and instead believes that reference should be omitted to the high quality corporate bond rate.

NSW Treasury agrees that, in principle, the IASB should come up with a consistent discount rate. However, we do not believe that the high quality corporate bond rate is the relevant rate because, this is inconsistent with the existing principles in IAS 19, which is based on the time value of money, excluding actuarial, investment or entity specific credit risk. The discount rate that is most consistent with this principle is the government bond rate, as the best indicator of the risk free rate in most countries.

However, we are of the opinion that even if it is accepted that the high quality corporate bond rate is the appropriate discount rate, the IAS 39 fair value guidance and the *Fair Value Measurement* Exposure Draft does not provide sufficient practical guidance to achieve the Board's objective of a more consistent outcome. This is because this guidance does not address significant issues such as how to identify what is regarded as a high quality corporate bond.

If you have any queries regarding NSW Treasury's comments, please contact myself on 612 9228 3019 or Dianne McHugh on 612 9228 5340.

Yours faithfully

R Williams

Robert Williams
for Secretary

NSW Treasury Response to IASB ED 2009/10
Discount Rate for Employee Benefits

Question 1 – Discount rate for employee benefits
Do you agree that the Board should eliminate the requirement to use government bond rates to determine the discount rate for employee benefit obligations when there is no deep market in high quality corporate bonds? Why or why not? If not, what do you suggest instead, and why?

Disagree. NSW Treasury believes that IAS 19 should not omit reference to the government bond rate. Instead IAS 19 should omit reference to the high quality corporate bond rate.

NSW Treasury agrees that, in principle, the IASB should come up with a consistent discount rate. However, we do not believe that the high quality corporate bond rate is the relevant rate because this is inconsistent with the existing principles in IAS 19. That is, the principle in IAS 19, para 79, is based on the time value of money, excluding actuarial, investment or entity specific credit risk. The discount rate that is most consistent with this principle is the government bond rate, as the best indicator of the risk free rate (except in countries where the government has a lower credit standing than the entity). We believe that the use of the high quality corporate bond rate is inappropriate in most countries as the rate incorporates risk.

This view is also consistent with the IAS 39, para AG82(a), which refers to the 'time value of money' and the government bond rate as the risk free rate.

We also believe that the use of the government bond rate increases consistency, compared to the use of the high quality corporate bond rate, as it eliminates the difficulty in estimating a high quality corporate bond rate in countries where there is no deep market. We are not convinced that using an estimated high quality corporate bond rate where there is no deep market results in an increase in consistency. This is further discussed in response to Question 2.

Question 2 – Guidance on determining the discount rate for employee benefits
For guidance on determining the discount rate, do you agree that an entity should refer to the guidance in IAS 39 Financial Instruments: Recognition and Measurement for determining fair value? Why or why not? If not, what do you suggest instead, and why?

Disagree.

As discussed in the response to Question 1 above, we believe that reference to the IAS 39 fair value guidance, para AG82(a), is inconsistent with the ED's proposal to eliminate reference to the government bond rate. That is, the IAS 39 guidance infers that the time value of money, which is the principle underlying IAS 19, is indicated by the government bond rate, except in countries where an entity has a better credit standing than the central government.

Further, even if it is accepted that the high quality corporate bond rate is the appropriate discount rate, the IAS 39 material does not provide sufficient practical guidance to calculate the estimated market yields on high quality corporate bonds, where there is no deep market. This is because this guidance does not address significant issues such as:

- o whether other markets outside the jurisdiction should be considered;
- o how to identify what is regarded as a high quality corporate bond; and
- o whether weighting of different bonds is appropriate.

Without this guidance, we do not believe that the Board will achieve its objective of a more consistent outcome. Further, we do not believe that the guidance in the Fair Value measurement exposure draft will resolve this issue.

Question 3 – Transition

The Board considered whether the change in the defined benefit liability (or asset) that arises from application of the proposed amendments should be recognised in retained earnings or as an actuarial gain or loss in the period of initial application (see paragraph BC10). Do you agree that an entity should:

(a) apply the proposed amendments prospectively from the beginning of the period in which it first applies the amendments?

(b) recognise gains or losses arising on the change in accounting policy directly in retained earnings?

Why or why not? If not, what do you suggest instead, and why?

NSW Treasury agrees with the IASB's comments in its Basis for Conclusions for both (a) and (b).

Other comments

NSW Treasury is concerned regarding the short time frame for comment. Given that this will have major impacts on countries that use the government bond rate, we believe that this issue should have been considered as part of a normal due process, to ensure a more thorough consideration and justification for the changes. We believe that this proposal should be considered as part of the other proposed amendments to IAS 19 which will be exposed for comment later this year.