Australian Government

Australian Accounting
Standards Board

Level 7, 600 Bourke Street
MELBOURNE VIC 3000
Postal Address
PO Box 204
Collins Street West VIC 8007
Telephone: (03) 9617 7600
Facsimile: (03)9617 7608

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Sir David Tweedie
Chairman
International Accounting Standards Board
1st Floor
30 Cannon Street
London EC4M 6XH
UNITED KINGDOM

Dear David

Exposure Draft ED/2009/10 *Discount Rate for Employee Benefits* (proposed amendments to IAS 19)

The Australian Accounting Standards Board (AASB) is pleased to submit its comments on the abovenamed Exposure Draft. In formulating these comments, the AASB sought and considered the views of Australian constituents. The comment letters received are published on the AASB's website.

The AASB is seriously concerned that the proposed change would, if pursued, and despite limited supporting argument and exposure process, have a profound effect on the recorded liabilities of Australian reporting entities (both in the private and public sectors). Those entities consistently use the government bond rate (in the absence of an active market for corporate bonds), a reasonable surrogate for a risk free discount rate.

Further, the AASB is most concerned that the IASB might, when it more fully reconsiders IAS 19 *Employee Benefits*, specify the use of a risk free discount rate. This would then lead to reversal of the very material effects of the changes to be made under the current proposal.

Accordingly, the AASB does not support eliminating the use of different discount rates by deleting from paragraph 78 of IAS 19 the requirement to use market yields on government bonds. The AASB does not consider consistency of method per se to be a sound basis for making decisions about measurement. Consistency is a reason for removing one of the discount rates from paragraph 78, but it does not provide a basis for determining which of the rates to eliminate. The AASB considers that the IASB should identify the measurement attribute for employee benefit liabilities and establish requirements accordingly.

Further, the AASB does not agree with the use of a limited exposure draft, and a limited period for comment, to introduce such a drastic change in reporting. The exposure draft gives the appearance of a short term reaction to unspecified European problems. The proposal might well garner support out of opportunism, but we have difficulty in seeing how

it could be supported conceptually or by reference to other standards. If we are wrong in our analysis, the exposure draft has not provided a basis for thinking otherwise.

We would invite the IASB to consider how, if it were the AASB, it would explain the proposed change to the Australian market.

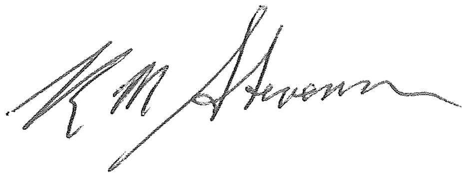
We would support elimination of the references to both government and corporate bond rates in favour of stating a principle – that if risk is allowed for in the estimates of cash flows, it should not be incorporated in the discount rate; in other words, a risk free rate should be applied.

For the longer term, the AASB would see considerable benefits in having separate and more comprehensive guidance on discount rates (similar to the planned outcome from the Exposure Draft *Fair Value Measurement*). The use of different discount rates in different IFRSs is a source of measurement inconsistencies and confusion among constituents.

The AASB's comments on the specific questions in the Exposure Draft are attached.

If you have queries regarding any matters in this submission, please contact Raymond Yu (ryu@aasb.gov.au) or me.

Yours sincerely



Kevin M. Stevenson
Chairman

AASB's Specific Comments on IASB Exposure Draft ED/2009/10 *Discount Rate for Employee Benefits* (proposed amendments to IAS 19)

The AASB's views on the questions in the Exposure Draft are as follows:

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?

No, the AASB does not agree.

The Exposure Draft states that the use of different discount rates means that entities with similar employee benefit obligations can report them at very different amounts and this effect is amplified by the global financial crisis. Also, paragraph BC7 of the Exposure Draft states that the IASB's objective in publishing the Exposure Draft is to introduce more consistency into existing requirements. The AASB does not consider consistency of itself to be a sound basis for making decisions about measurement. Ensuring consistency might mean compromising another qualitative characteristic of financial report. Requiring the discount rate in all cases to be based on market yields on high quality corporate bonds at the end of the reporting period would improve comparability in financial statements across entities (paragraph BC4(a) of the Exposure Draft), but it may compromise relevance and reliability of financial reports for entities using a better surrogate for a risk free rate.

The AASB considers that, in the longer term, the IASB should identify the measurement attribute for employee benefit liabilities and establish requirements accordingly.

The AASB appreciates that in paragraph BC7 of the Exposure Draft, the IASB has not considered whether using the yield on high quality corporate bonds is the most appropriate approach to determining discount rates for post-employment benefit obligations. However, the reason provided for eliminating the reference to market yields on government bonds is consistency, which could equally be used to support the elimination of the reference to market yields on high quality corporate bonds. Reference to market yields on government bonds could be supported over the reference to market yields on high quality corporate bonds for the following reasons:

(a) market yields on government bonds are generally more observable than market yields on high quality corporate bonds;

(b) paragraph BC31 of IAS 19 states that the discount rate should reflect only the time value of money (i.e. be risk free) and it is arguable that referring to market yields on government bonds would generally better reflect this objective; and

(c) paragraph AG82(a) of IAS 39 *Financial Instruments: Recognition and Measurement* (which it is proposed be used as guidance for estimating market yields on high quality corporate bond in the Exposure Draft) also refers to the 'time value of money' and deriving a 'basic' or 'risk free' rate from observable government bond prices.

If the IASB proceeds with eliminating the reference to market yields on government bonds, the AASB considers that the IASB should explain in its Basis for Conclusions why it decided to try and achieve greater consistency by requiring that reference be made to market yields on high quality corporate bonds, rather than market yields on government bonds.

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?

The AASB agrees that an entity could potentially refer to the guidance in IAS 39 for determining fair value as guidance for determining the discount rate as a short term measure.

However, the AASB is of the view that the fair value measurement guidance in IAS 39 is unlikely to provide sufficient practical guidance to estimate market yields on high quality corporate bonds when there is no deep market. This is because this guidance does not address significant issues such as:

(a) whether other markets outside the jurisdiction of the relevant employees should be considered (for example, when an entity could or does finance itself on an international basis);

(b) how to identify what is regarded as a high quality corporate bond; and

(c) whether weighting of different bonds is appropriate.

For the longer term, the AASB would see benefits in having separate and more comprehensive guidance on discount rates (similar to the planned outcome from the Exposure Draft *Fair Value Measurement*). The use of different discount rates in different IFRSs is a source of measurement inconsistencies and confusion among constituents.

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?

The AASB agrees with both proposals in principle. However, the AASB is concerned that the focus on defined benefit liabilities may not be appropriate. Paragraph 78 of IAS 19 is worded in terms of 'post-employment benefit obligations', but the discount rate is also used in measuring:

(a) contributions owed to a defined contribution plan not due within 12 months (paragraph 45 of IAS 19);

(b) termination benefits not due within 12 months (paragraph 139 of IAS 19); and

(c) any other long-term employee benefit liabilities (such as long-service leave).

The AASB is also concerned that the Basis for Conclusions (paragraph BC8(a)) seems to be adopting a different meaning for 'impracticable' than its defined meaning in IAS 8 *Accounting Policies, Changes in Accounting Estimates and Errors* which is "applying a requirement is impracticable when the entity cannot apply it after making every reasonable effort to do so". In the AASB's view, paragraph BC8(a) is justifying why applying changes in accounting policy retrospectively is not practical or does not satisfy a cost-benefit test rather than why is it 'impracticable' (which the AASB understands to be a higher hurdle). The AASB has previously raised this issue in the context of paragraphs BC11-BC12 of Exposure Draft *Additional Exemptions for First-time Adopters* (proposed amendments to IFRS 1). The AASB recommends that the IASB should either formally revisit the definition of 'impracticable' or change paragraph BC8(a) to reflect that it is using a test other than impracticability as the basis for its transitional arrangements.