August 2009

Exposure Draft ED/2009/10

Discount Rate for Employee Benefits

Proposed amendments to IAS 19

Comments to be received by 30 September 2009

International
Accounting Standards
Board®

Exposure Draft

DISCOUNT RATE FOR EMPLOYEE BENEFITS
(proposed amendments to IAS 19)

Comments to be received by 30 September 2009

ED/2009/10

This exposure draft *Discount Rate for Employee Benefits* (proposed amendments to IAS 19) is published by the International Accounting Standards Board (IASB) for comment only. The proposals may be modified in the light of the comments received before being issued as amendments to IAS 19. Comments on the exposure draft and the Basis for Conclusions should be submitted in writing so as to be received by **30 September 2009.** Respondents are asked to send their comments electronically to the IASB website (www.iasb.org), using the 'Open to Comment' page.

All responses will be put on the public record unless the respondent requests confidentiality. However, such requests will not normally be granted unless supported by good reason, such as commercial confidence.

ISBN: 978-1-907026-32-4

International
Accounting Standards
Board®

Additional copies of this publication may be obtained from:
IASC Foundation Publications Department,
1st Floor, 30 Cannon Street, London EC4M 6XH, United Kingdom.
Tel: +44 (0)20 7332 2730 Fax: +44 (0)20 7332 2749
Email: publications@iasb.org Web: www.iasb.org

CONTENTS

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.

This exposure draft contains proposals by the International Accounting Standards Board to eliminate the use of different rates by deleting from IAS 19 the requirement to use market yields on government bonds. The Board intends to review the accounting for employee benefits more broadly in due course. These proposals are not intended to pre-empt that review.

Invitation to comment

The Board invites comments on all aspects of this exposure draft and in particular on the questions set out below. Respondents need not comment on all of the questions. Comments are most helpful if they:

(a) respond to the questions as stated

(b) indicate the specific paragraph or paragraphs to which the comments relate

(c) contain a clear rationale

(d) describe any alternatives that the Board should consider.

The Board is not requesting comments on matters not addressed in this exposure draft. Comments should be submitted in writing and must arrive no later than **30 September 2009**.

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?

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?

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?

---

* In May 2009, the Board published an exposure draft *Fair Value Measurement*. That exposure draft contains proposals to replace guidance on fair value in IAS 39. The Board will update this reference to be consistent with paragraphs 38–54 of *Fair Value Measurement* when it issues an IFRS resulting from the proposals in that exposure draft.

Proposed amendments to IAS 19 *Employee Benefits*

Paragraph 78 is amended and paragraph 81 is deleted (new text is underlined and deleted text is struck through). Paragraphs 156A and 159E are added.

Post-employment benefits: defined benefit plans

Recognition and measurement: present value of defined benefit obligations and current service cost

Actuarial assumptions: discount rate

78 **<u>An entity shall</u> ~~The rate used to~~ discount <u>funded and unfunded</u> post-employment benefit obligations ~~(both funded and unfunded) shall be~~ <u>using rates</u> determined by reference to market yields ~~at the end of the reporting period~~ on high quality corporate bonds <u>at the end of the reporting period</u>. ~~In countries where there is no deep market in such bonds, the market yields (at the end of the reporting period) on government bonds shall be used. The currency and term of the corporate bonds or government bonds shall be~~ <u>An entity shall apply the principles and approach in paragraphs AG69–AG82 of IAS 39</u>** <u>*Financial Instruments: Recognition and Measurement*</u>[*] **<u>to estimate such rates by reference to yields on high quality corporate bonds denominated in the same currency and whose term is</u> consistent with the ~~currency and~~ estimated term of the post-employment benefit obligations.**

81 <u>[Deleted]</u> ~~In some cases, there may be no deep market in bonds with a sufficiently long maturity to match the estimated maturity of all the benefit payments. In such cases, an entity uses current market rates of the appropriate term to discount shorter term payments, and estimates the discount rate for longer maturities by extrapolating current market rates along the yield curve. The total present value of a defined benefit obligation is unlikely to be particularly sensitive to the discount rate applied to the portion of benefits that is payable beyond the final maturity of the available corporate or government bonds.~~

---

* In May 2009, the Board published an exposure draft *Fair Value Measurement*. That exposure draft contains proposals to replace guidance on fair value in IAS 39. The Board will update this reference to be consistent with paragraphs 38–54 of *Fair Value Measurement* when it issues an IFRS resulting from the proposals in that exposure draft.

Transitional provisions

156A An entity shall:

(a) apply the amendments in paragraph 78 and the deletion of paragraph 81 prospectively from the beginning of the reporting period in which it initially applies them.

(b) recognise any resulting net change in the defined benefit liability (or asset), including any effect on the limit in paragraph 58(b) as an adjustment to retained earnings at the beginning of that period, and disclose the amount of that adjustment.

Effective date

159E Paragraph 78 was amended and paragraph 81 was deleted by [draft] *Discount Rate for Employee Benefits* issued in [date to be inserted after exposure] 2009. An entity shall apply those amendments for annual periods beginning on or after [date to be inserted after exposure]. Earlier application is permitted. If an entity applies the amendments for an earlier period, it shall disclose that fact.

Approval by the Board of *Discount Rate for Employee Benefits* (proposed amendments to IAS 19) published in August 2009

The exposure draft *Discount Rate for Employee Benefits* (proposed amendments to IAS 19) was approved for publication by the fifteen members of the International Accounting Standards Board.

Sir David Tweedie Chairman

Stephen Cooper

Philippe Danjou

Jan Engström

Patrick Finnegan

Robert P Garnett

Gilbert Gélard

Amaro Luiz de Oliveira Gomes

Prabhakar Kalavacherla

James J Leisenring

Patricia McConnell

Warren J McGregor

John T Smith

Tatsumi Yamada

Wei-Guo Zhang

Basis for Conclusions

This Basis for Conclusions accompanies, but is not part of, the proposed amendments to IAS 19.

BC1 This Basis for Conclusions summarises the International Accounting Standards Board's considerations in proposing amendments to IAS 19 *Employee Benefits*. Individual Board members gave greater weight to some factors than to others.

BC2 The Board developed the proposed amendments to deal with an issue that arises from the requirement in IAS 19 concerning the discount rate used to determine the present value of the defined benefit obligation. The Board was informed, through discussions with its Employee Benefits Working Group, the Pensions and Employee Benefits Committee of the International Actuarial Association and other interested parties, that this requirement means that entities with similar employee benefit obligations can report them at very different amounts. This effect has been much greater as a result of the global financial crisis because of the significant widening of the spread between yields on corporate bonds and yields on government bonds. The Board was also told that it could resolve the issue relatively easily without pre-empting the Board's plans for a more fundamental review of accounting for employee benefits. Accordingly, the Board decided to publish a stand-alone exposure draft dealing with the issue so that it could finalise any amendments in time for early adoption by entities with December 2009 year-ends.

The proposed amendments

The rate used to discount employee benefits

BC3 IAS 19 requires an entity to determine the rate used to discount employee benefits by reference to market yields on high quality corporate bonds. When there is no deep market in such bonds, IAS 19 requires an entity to use market yields on government bonds. As a result, an entity may report a significantly higher defined benefit obligation in a jurisdiction that does not have a deep market in high quality corporate bonds than it would in a similar jurisdiction that does have a deep market in such bonds, even when the underlying obligations are very similar.

BC4 To eliminate these differences, the Board proposes that the discount rate should in all cases be based on market yields on high quality corporate bonds at the end of the reporting period. That would have the following advantages:

(a) It would reduce the range of rates used. This would improve comparability in financial statements across entities and through time for the same entity (because markets for high quality corporate bonds may not remain deep over time). In jurisdictions that do not have a deep market in high quality corporate bonds, entities would no longer systematically report liabilities that are higher than equivalent obligations in other jurisdictions.

(b) Entities would no longer need to assess whether a particular corporate bond market is deep.

BC5 In some circumstances, an entity will need to estimate the yield on high quality corporate bonds. Such estimates may be more subjective than estimates of yields on government bonds. Nevertheless, the Board concluded that entities could make such estimates with no more subjectivity than is required for many other accounting estimates.

BC6 Estimating the yield on a bond is essentially the same task as estimating the fair value of the bond. Accordingly, the Board proposes to replace paragraph 81 of IAS 19 with a cross-reference to IAS 39 *Financial Instruments: Recognition and Measurement* as a means of providing appropriate guidance for estimating bond yields. The Board expects to replace that guidance in 2010 when it issues an IFRS resulting from the proposals in the exposure draft *Fair Value Measurement* published in May 2009.

BC7 The Board intends to review the accounting for employee benefits more broadly in due course. These proposals are not intended to pre-empt that review. The Board has not yet considered whether the measurement of employee benefit obligations could be improved more generally and, in particular, the Board has not yet considered whether the yield on high quality corporate bonds is the most appropriate discount rate for post-employment benefit obligations. The Board's objective in publishing these proposals is only to introduce more consistency into the existing requirements.

Transition and effective date

BC8 IAS 8 *Accounting Policies, Changes in Accounting Estimates and Errors* requires entities to apply changes in accounting policy retrospectively, unless either it is impracticable to do so or the change in accounting policy results from another IFRS that contains specific transitional provisions. In determining whether to propose specific transitional arrangements for the proposals in the exposure draft, the Board noted the following:

(a) when an entity applies the 'corridor approach' in IAS 19, retrospective application of the proposed amendments would require an entity to determine the defined benefit obligation for each year since the inception of the plan in order to determine the net cumulative unrecognised gains or losses at the date of application. In the Board's view, this process would be costly and the resulting information would not benefit users.

(b) in jurisdictions in which there is no observable market price for high quality corporate bonds, or few or no observable inputs, retrospective application may be impracticable because it may require judgments that could be affected by hindsight.

BC9 Accordingly, the Board proposes that an entity should apply the proposed amendments prospectively from the beginning of the period in which it initially applies them.

BC10 The Board considered whether the change in the defined benefit liability (or asset) that arises from application of the proposed amendments should be recognised as an actuarial gain or loss in the period of initial application. Those actuarial gains and losses would be recognised in accordance with the entity's accounting policy for actuarial gains and losses. Other changes in discount rate are accounted for in this way. However, the proposed amendments would result in a change in accounting policy for some entities. Recognising the effect of such change as an actuarial gain or loss would combine information about gains and losses associated with changes in circumstances with those resulting from the change in accounting policy. Accordingly, the exposure draft proposes that any effect arising from the change should be recognised directly in retained earnings, in the same way as other changes in accounting policy.

BC11 The Board will set the effective date for the proposed requirements when it approves the amendments. The Board normally sets an effective date of between six and eighteen months after issuing amendments.

BC12 The Board also expects to publish late this year an exposure draft of amendments to IAS 19 that addresses presentation of defined benefit post-employment benefits and disclosures about them. The Board considered the implications for entities of its decision to publish two exposure drafts on amendments to IAS 19 within a relatively short period. However, as explained in paragraph BC2, the Board believes that the proposed amendments in this exposure draft are urgent and that some entities may wish to apply them in their December 2009 financial statements. Accordingly, the Board intends to set the same effective date for the amendments resulting from both exposure drafts, but permit early adoption of these proposed amendments.

Exposure period

BC13 The Board intends to finalise any amendments resulting from this exposure draft as soon as possible in order to make them available for early adoption by entities with December 2009 year-ends. Accordingly, the Board decided that the comment period would end on 30 September 2009. The Board believes that an exposure period shorter than the Board's normal 120 days is justified because the matter is urgent, the proposed amendments are straightforward and the document is short. In addition, the Board believes from discussions with the Pensions and Employee Benefits Committee of the International Actuarial Association, the Board's Employee Benefits Working Group and other interested parties that the proposed amendments would provide a worthwhile, necessary and urgent improvement to IAS 19.

