



Accounting Standards Board

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International Accounting Standards Board
30 Cannon Street
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Dear Sirs

Exposure Draft: Discount Rate for Employee Benefits (ED/2009/10)

I am responding on behalf of the Accounting Standards Board (ASB) to the Exposure Draft: Discount Rate for Employee Benefits (ED).

The ASB does not support the proposals in the exposure draft because it does not see a need to amend the current requirements in paragraph 78 of IAS 19 'Employee Benefits'. In its view IAS 19 paragraph 78 requires the rate to be used to discount post-employment benefits *by reference* to market yields on high quality corporate bonds. Where there is no deep market in such bonds then market yields on government bonds is used. In the ASB's view the requirement to use the market yield on government bonds is only *by reference* and not a requirement to apply a government bond rate without reference to high quality corporate bonds. Consequently, the ASB considers that it would be more appropriate for the IASB to withdraw the project noting that the current requirement is only to apply the rate *by reference*.

The ASB intends to publish later this year its recommendations following redeliberations of the ProActive Accounting in Europe Discussion Paper 'The Financial Reporting of Pensions'. This report sets out the ASB redeliberations informed by comments received from the consultation process with the aim of providing recommendations on how a future financial reporting standard on pensions might be developed. The ASB has concluded its redeliberations of the proposals in the discussion paper and, specifically, in relation to the discount rate has affirmed its view that the discount rate to be applied to pension liabilities should be a risk-free rate. In its view the risk associated with the size and variability of the pension liability is more appropriately addressed through disclosure.

The ASB responses to the invitation to comment are set out in Appendix to this letter.

Should you have any queries regarding our response please contact me or Michelle Sansom, Project Director, on 020 7492 2432 or by email m.sansom@frc-asb.org.uk.

Yours sincerely

A handwritten signature in black ink, appearing to read 'Ian Mackintosh', written in a cursive style.

Ian Mackintosh

Chairman

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Appendix: Response to the Invitation to Comment

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?

Response:

1. As noted in its covering letter the ASB does not agree with the proposal in the exposure draft because:
 - (a) in its view IAS 19 paragraph 78 requires the rate to be used to discount post-employment benefits *by reference* to market yields on high quality corporate bonds. Where there is no deep market in such bonds then market yields on government bonds is used. In the ASB's view the requirement to use the market yield on government bonds is only *by reference* and not a requirement to apply a government bond rate without reference to high quality corporate bonds; and
 - (b) the spread on corporate bonds has began to narrow in recent months and the problem may actually resolve itself without need to amend the standard.
2. The ASB notes that its forthcoming report following redeliberations of the ProActive Accounting in Europe discussion paper 'The Financial Reporting of Pensions' recommends the use of a risk-free discount rate that reflects the time value of money only. The ASB considers that the risk associated with the size and variability of the pension liability is more appropriately addressed through disclosure.
3. The ASB considers it is important that financial statements include a sensitivity analysis for the principal assumptions used to measure the post employment benefit obligation which shows how the measurement of the obligation is affected by changes in the discount rate. The ASB would therefore stress the importance of improving disclosures in financial statements.

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 value¹? Why or why not? If not, what do you suggest instead, and why?

Response:

4. In addition to not supporting the proposed amendment to the standard the ASB does not support the requirement to apply the principles and approach in IAS 39 'Financial Instruments: Recognition and Measurement' to estimate market yields should the IASB decide to proceed with the proposed amendment.
5. The ASB is concerned the focus of the guidance in paragraphs AG69 to AG82 of IAS 39 is a price *of a* financial instrument. It does not make reference to estimating market yields on high quality corporate bonds. Consequently the ASB questions the usefulness of the guidance to the requirements proposed in the ED.
6. The ASB recognises that guidance on estimating market yields on high quality corporate bonds does not currently exist in IFRS literature and therefore the IASB faces the situation where it needs to develop new guidance to support the proposed requirement in the ED should it decide to proceed with the development of the ED. In the ASB's view this provides further justification for not proceeding with the proposed amendment. The ASB considers that it would be more appropriate for the IASB to withdraw the project noting that the current requirement is only to apply the rate *by reference*.
7. Finally the ASB has a concern in relation to the requirement to "*estimate such rates by reference to yields on high quality corporate bonds denominated in the same currency*". The ASB considers that an entity will be estimating rates where there is no active market in its currency and might therefore not be able to find corporate bonds denominated in the same currency as the post-employment benefit obligation. The ASB suggests that should the IASB proceed with the ED clarification is required here.

¹ In May 2009, the IASB published an exposure draft *Fair Value Measurement*. That exposure draft contains proposals to replace guidance on fair value in IAS 39. The IASB 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.

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?

Response:

- 8. Should the IASB decide to proceed with the amendment then the ASB agrees that practically it is necessary for an entity to apply the requirements prospectively. Retrospective application would require historical liabilities to be restated and historical rates to be estimated.
- 9. The ASB also considers that the government bond rate is used as a proxy for the corporate bond rate and consequently the change in rate is not a change in accounting policy but a change in accounting estimate. Consequently, the ASB does not consider the gain or loss should be recognised in retained earnings.
- 10. The ASB would prefer the gain or loss be included in actuarial gains and losses and identified separately in the notes to the financial statements, at least in the first year of implementation. This would enable users of financial statements to evaluate the affect of the change in rates on the post employment benefit obligation.