STAFF PAPER

October 2013

IASB Meeting

Project	**Annual Improvements to IFRSs—2012-2014 cycle**
Paper topic	IAS 19 *Employee Benefits*—Discount rate: Regional market issue

CONTACT(S) Leonardo Piombino lpiombino@ifrs.org +44 (0)20 7246 0571

Introduction

1. In June 2013, the IFRS Interpretations Committee ('the Interpretations Committee') was asked to clarify the application of the requirements of IAS 19 *Employee Benefits* (2011) on determination of the discount rate to a regional market consisting of multiple countries sharing the same currency (eg the Eurozone).

2. In its July 2013 meeting, the Interpretations Committee recommended that the IASB should propose an amendment to paragraph 83 of IAS 19 through Annual Improvements in order to clarify that in determining the discount rate an entity shall include high quality corporate bonds (HQCB) issued by entities operating in other countries, provided that these bonds are issued in the currency in which the benefits are to be paid.

Purpose of this paper

3. The objective of this paper is to:

   (a) provide a brief description of the issue;

   (b) explain the rationale for the Interpretations Committee's decision to recommend that the IASB should amend IAS 19 through Annual Improvements;

(c) ask for the IASB's agreement with the Interpretations Committee's recommendation; and

(d) ask the IASB whether it wants to clarify which government bonds should be used in a multi-country regional market sharing the same currency.

The issue

4. The submitter states that:

(a) the valuation of post-employment benefit obligations in accordance with IAS 19 continues to be a very topical issue in the preparation of IFRS financial statements, notably in the current environment of low interest rates in Europe;

(b) market participants have expressed concerns about the consistency of application of the requirements of IAS 19 in relation to the determination of the discount rate with reference to HQCB and with reference to a regional market sharing the same currency or currencies pegged to this regional currency;

(c) according to paragraph 83 of IAS 19, **in countries** where there is no deep market for HQCB the market yields on government bonds shall be used (emphasis added);

(d) in June 2005 the Interpretations Committee decided that "the reference to 'in a country' could reasonably be read as including high quality corporate bonds that are available in a regional market to which the entity has access, provided that the currency of the regional market and the country were the same (eg the euro).":

(e) in January 2013 the Interpretations Committee reaffirmed this position and clarified that "for a liability expressed in euro, the deepness of the market of high quality corporate bonds should be assessed at the Eurozone level";

(f) the Interpretations Committee's agenda decisions are important source of guidance, but they do not have the same authoritative status as amendments to Standards; and

(g) if no explicit clarification is made, potentially diversity in practice will persist.

5. On the basis of the above, the submitter asks the IASB to clarify whether the basket of HQCB should be determined at a country level or at a currency zone level.

Interpretations Committee's decisions and recommendations

6. In its February 2013[1] meeting, the IASB asked the Interpretations Committee to clarify the requirements of IAS 19 on the determination of the discount rate for post-employment benefits obligations.

7. The Interpretations Committee discussed the courses of action proposed by the staff in March, May and July 2013.

8. In its May 2013[2] meeting, the Interpretations Committee considered the staff proposals for a narrow-scope amendment and decided that the staff proposals were too broad an amendment to IAS 19.

9. In its July 2013 meeting, the Interpretations Committee:

    (a) tentatively[3] decided to stop its project on the determination of the discount rate (ie the narrow-scope amendment asked for by the IASB in February 2013), because the Interpretations Committee noted that issuing additional guidance on, or changing the requirements for, the determination of the discount rate would be too broad for it to address in an efficient manner (a separate paper reporting the Interpretations Committee's discussions and conclusions will be brought to the IASB after the Interpretations Committee has finalised its agenda decision on the matter at its meeting in November);

---

[1] See February 2013 IASB Update http://media.ifrs.org/2013/IASB/February/IASB%20Update_February_2013_HTML.html#Matters-arising-IFRS-IC

[2] See May 2013 IFRIC Update http://media.ifrs.org/2013/IFRIC/May/IFRICUpdateMay2013.html#7

[3] The Interpretations Committee issued a tentative agenda decision, see the July 2013 *IFRIC Update* http://media.ifrs.org/2013/IFRIC/July/IFRIC-Update-July-2013.html#6. The Interpretations Committee expects to finalise its tentative agenda decision in its November 2013 meeting.

(b) recommended that the IASB should amend paragraph 83 of IAS 19 through Annual Improvements in order to clarify that in determining the discount rate an entity shall include high quality corporate bonds issued by entities operating in other countries, provided that these bonds are issued in the currency in which the benefits are to be paid. Consequently, the depth of the market for high quality corporate bonds should be assessed at the currency level and not at the country level; and

(c) requested the staff to ask the IASB whether it wants to clarify which government bonds should be used in a multi-country regional market sharing the same currency. This issue could arise in the absence of a deep market in high quality corporate bonds issued in such a currency.

Staff analysis

Issue 1: the recommended Annual Improvement

10. The Interpretations Committee recommended that the IASB should amend the second sentence of paragraph 83 of IAS 19 through Annual Improvements by replacing the word "countries" with the word "currencies", because the third sentence of the same paragraph refers to "currency". It states that: "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".

11. The draft wording for the proposed Annual Improvement is in **Appendix A** of this paper.

Agenda criteria assessment

12. Our assessment of the Interpretations Committee's agenda criteria is as follows:

We should address issues(5.16):	
that have widespread effect and have, or are expected to have, a material effect on those affected; where financial reporting would be improved through the elimination, or reduction, of diverse reporting methods; and that can be resolved efficiently within the confines of	Yes. The issue is widespread and may have a significant effect on the entities affected. We are aware that different views exist in practice. The issue can be resolved within the confines of IAS 19.

existing IFRSs and the *Conceptual Framework for Financial Reporting*.	
In addition:	
Is the issue sufficiently narrow in scope that the Interpretations Committee can address this issue in an efficient manner, but not so narrow that it is not cost-effective for the Interpretations Committee to undertake the due process that would be required when making changes to IFRSs (5.17)?	Yes, this issue is narrow in scope and can be resolved efficiently.
Will the solution developed by the Interpretations Committee be effective for a reasonable time period (5.21)? (The Interpretations Committee will not add an item to its agenda if the issue is being addressed in a forthcoming Standard and/or if a short-term improvement is not justified).	Yes, this issue will not be addressed in a forthcoming Standard, because the Interpretations Committee has tentatively decided to terminate its project on the discount rate.

Annual improvements criteria assessment

13. Our assessment of the issue against the annual improvements criteria is as follows:

In addition to the implementation and maintenance criteria, an AIP should (6.11, 6.12):	
Replace unclear wording or Provide missing guidance or Correct minor unintended consequences, oversights or conflict	Yes. In our view the wording of paragraph 83 of IAS 19 may be clarified by deleting the reference to "countries".
Not change an existing principle or propose a new principle	Yes. We are not changing an existing principle or proposing a new principle. The principle will remain that the currency of the corporate bonds or government bonds shall be consistent with the currency of the post-employment benefit obligations.
Not be so fundamental that the IASB will have to meet several times to conclude (6.14)	Yes. This is only a clarification.

Issue 2: Which government bonds should be used?

14. The Interpretations Committee discussed, but did not reach a consensus on, which government bonds should be used to determine the discount rate if there is not a deep market in HQCB in a multi-country regional market sharing the same currency (eg the Eurozone).

15. The question is whether an entity should use the government bonds issued by the government of its country regardless of their credit quality, or whether it should use high quality government bonds issued by other governments in the regional market.

16. Some Interpretations Committee members think that Issue 2 should be addressed now, because it will probably arise in the comment letters on this Annual Improvement (if the IASB agrees to propose this amendment).

17. Other Interpretations Committee's members think that Issue 2 should not be addressed for now, because they argue that at present there is a deep market in HQCB issued in euro and so this issue does not exist in practice.

18. We note that some Interpretations Committee members think that there is currently a deep market in HQCB issued in euro and that the submitter (ESMA) did not raise this additional question on which government bonds should be used in a regional market sharing the same currency.

19. We also note that:

    (a) in February 2013 the IASB agreed that the Interpretations Committee should propose amendments to IAS 19 to specify that when government bonds are used to determine the discount rate those bonds should be of high quality;

    (b) in July 2013 the Interpretations Committee tentatively decided to stop this narrow-scope project. One of the main reasons to stop the project, in our view, was that the Interpretations Committee was unable to reach a consensus on what an entity should do when high quality government bonds are not available in the same currency as the obligation; and

    (c) consequently, we think that if the IASB wants to amend IAS 19 to specify that the government bonds used to determine the discount rate should be of high quality, then this should be addressed in a separate narrow scope project. In our view, this issue is too broad to be addressed in a short-term project and so it would be more appropriate to address it in the IASB research project on the discount rates.

20. On the basis of the above, we think that the IASB should not address Issue 2 in this Annual Improvement.

Staff's recommendations

21. We recommend that the IASB:

    (a) should propose to amend IAS 19 through Annual Improvements to clarify that in determining the discount rate, an entity shall include HQCB issued by entities operating in other countries, provided that these bonds are issued in the currency in which the benefits are to be paid; and

    (b) should not specify, in this Annual Improvement, which government bonds should be used in a multi-country regional market sharing the same currency.

22. The draft wording for the proposed Annual Improvement is in **Appendix A** of this paper.

Questions to the IASB

Questions
1. Does the IASB agree with the Interpretations Committee's recommendation to propose an amendment to IAS 19 through Annual Improvements to clarify that in determining the discount rate an entity shall include HQCB issued by entities operating in other countries, provided that these bonds are issued in the currency in which the benefits are to be paid?
2. Does the IASB agree with the staff's recommendation to not specify, in this Annual Improvement, which government bonds should be used in a multi-country regional market sharing the same currency?

Appendix A—Draft wording for the proposed amendments

A1 The proposed amendment to IAS 19 is presented below.

Proposed amendments to IAS 19 *Employee Benefits*

Paragraph 83 is amended as follows: (new text is underlined and deleted text is struck through).

83 The rate used to discount post-employment benefit obligations (both funded and unfunded) shall be determined by reference to market yields at the end of the reporting period on high quality corporate bonds. In ~~countries~~ <u>currencies</u> where there is no deep market in such high quality corporate 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 consistent with the currency and estimated term of the post-employment benefit obligations.

<u>175 *Annual Improvements 2012–2014* cycle, issued in [date], amended paragraph 83. An entity shall apply that amendment retrospectively in accordance with IAS 8 *Accounting Policies, Changes in Accounting Estimates and Errors* for annual periods beginning on or after [date]. Earlier application is permitted. If an entity applies that amendment for an earlier period it shall disclose that fact.</u>

Basis for Conclusions on proposed amendments to IAS 19 *Employee Benefits*

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

BC1 The IFRS Interpretations Committee ('the Interpretations Committee') was asked to clarify the requirements of IAS 19 *Employee Benefits* to determine the discount rate in a regional market sharing the same currency (eg the Eurozone). The issue arose because some think that the basket of high quality corporate bonds should be determined at a country level, and not at a currency level, because paragraph 83 of IAS 19 states that 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.

BC2 The Interpretations Committee noted that paragraph 83 of IAS 19 states that 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.

BC3 The Interpretations Committee therefore recommended that the IASB should amend paragraph 83 of IAS 19 through Annual Improvements in order to clarify that the basket of high quality corporate bonds used to estimate the discount rate should be determined at the currency level. These bonds should be issued in the same currency in which the benefits are to be paid. Consequently, the depth of the market for high quality corporate bonds should be assessed at currency level and not at country level.