STAFF PAPER

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IASB Meeting

Project	**Annual Improvements to IFRSs 2012-2014 Cycle (ED/2013/11)—Comment letter analysis**
Paper topic	IAS 19 *Employee Benefits*–Discount rate: regional market issue

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Introduction

1. The Exposure Draft ED/2013/11 *Annual Improvements to IFRSs 2012–2014 Cycle* published in December 2013 (the ED) includes a proposal for an amendment to IAS 19 *Employee Benefits* to clarify that:

   (a) the high quality corporate bonds ('HQCB') used to estimate the discount rate for post-employment benefit obligations should be denominated in the same currency as the liability; and

   (b) the depth of the market for HQCB should be assessed at the currency level.

Purpose of this paper

2. The objective of this paper is:

   (a) to present to the IASB the Interpretations Committee's recommendations on the proposed amendment to IAS 19; and

   (b) to obtain a IASB decision on the finalisation of this amendment.

The issue

3. The IASB was asked to clarify the requirements of IAS 19 to determine the discount rate in a regional market consisting of multiple countries sharing the same currency (eg the Eurozone).

4. The issue arose because paragraph 83 of IAS 19 states that **in countries** where there is no deep market in HQCB, the market yields (at the end of the reporting period) on government bonds shall be used. In other words, IAS 19 requires an entity to identify a market for corporate bonds, and assess whether that market is a deep market, in order to decide whether it should use an HQCB yield or a government bond yield as its discount rate. Consequently, the issue is, when making the assessment of market depth, whether an entity should look at:

   (a) the market for corporate bonds within its country; or

   (b) the market for corporate bonds within the same currency.

5. In June 2005, the Interpretations Committee issued an agenda decision, which states: "*The IFRIC observed 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). This would not apply if the country currency differed from that of the regional market*".

6. The proposed amendment clarifies that, when assessing the depth of the market for HQCB, an entity should look at the market for HQCB denominated in the same currency of the liability.

Main comments raised by respondents

7. The majority of the respondents conditionally agree with the proposed amendment. However, many respondents have concerns about the proposal.

8. For a detailed description of the comments received and the source of those comments, the IASB should refer to Agenda Paper 17D[1] presented to the Interpretations Committee at the May 2014 meeting.

9. In this paper, we want to bring to the IASB attention that some respondents have concerns about the potential effects of the proposed amendment on:

   (a) countries that have adopted a 'stronger' currency as their official or legal currency (eg Panama, El Salvador and Ecuador have adopted USD) without being members of a regional market or part of one with a common currency; and

   (b) entities that denominate defined benefit obligations in a 'stronger' currency (eg Zimbabwean entities usually denominate employee payments in USD).

10. Those respondents think that the proposed amendment could result in anomalous outcomes in these countries, because a discount rate determined from HQCB denominated in a strong currency (eg USD) could be inconsistent with the inflation rate (and the other assumptions) used in these countries to determine the cost of providing post-employment benefits. They note that according to paragraph 75 of IAS 19 actuarial assumptions shall be mutually compatible. They also note that paragraph 78 of IAS 19 states:

> Actuarial assumptions are mutually compatible if they reflect the economic relationships between factors such as inflation, rates of salary increase and discount rates. For example, all assumptions that depend on a particular inflation level (such as assumptions about interest rates and salary and benefit increases) in any given future period assume the same inflation level in that period.

11. Consequently, some respondents suggest that before finalising the amendment, the IASB should carry out some further analysis to ensure there are no unintended consequences and to ensure that where the discount rate is derived from corporate

[1] http://www.ifrs.org/Meetings/MeetingDocs/Interpretations%20Committee/2014/May/AP17D%20-%20AIP%20CL%20-%20IAS19%20-%20Discount%20rate.pdf

bonds issued in a 'stronger' currency, there is common understanding of mutually compatible inflation, discount rates and other assumptions.

The Interpretations Committee's recommendations

12. The Interpretations Committee recommended to the IASB that it should finalise the proposed amendment to IAS 19 as proposed and without performing further analysis on this issue.

13. We understand that the majority of the Interpretations Committee members think that this additional analysis will delay the finalisation of the proposed amendment without providing any real benefits (ie new useful information). When the Interpretations Committee recommended the proposed amendment, the members knew that the proposal could result in discount rates that would not have been compatible with the other actuarial assumptions. However, they think that the proposed amendment is an improvement that should not be held up for a narrow range of situations that they have already considered in recommending this proposal.

14. We also understand that the majority of the Interpretations Committee members do not see a real difference between a country that has adopted another currency and a country that is part of a regional market that shares the same currency. Even though they acknowledge that in the former case the country has less control over the currency, they do not think that two different answers can be justified by this difference. This is because a particular country within a currency zone is likely to experience economic characteristics, especially inflation, that is different from other countries in the same currency zone. Similarly, one particular part of a single country, eg a state or a province, may experience different economic characteristic from other parts of the same country.

15. We also understand that the majority of the Interpretations Committee members think that the scope of the proposed amendment should not be increased; because the Interpretations Committee has already discussed a potential broader amendment relating to the discount rate and did not reach a consensus.

16. The Interpretations Committee also recommended to the IASB that the amendment should be applied from the beginning of the earliest comparative period presented in the first financial statements in which the entity applies the amendment, with any cumulative catch-up adjustment recognised in opening retained earnings. This is because a full retrospective application of the amendment (as proposed) can be burdensome for some entities.

Annual Improvements criteria reassessment

17. We think that the proposed amendment to IAS 19 meets the Annual Improvements criteria established by the *Due Process Handbook* issued in February 2013, because it clarifies a perceived discrepancy within paragraph 83 of IAS 19. These criteria are reported in Appendix A of this paper.

Questions for the IASB
1. Does the IASB agree with the Interpretations Committee's recommendation to finalise, in the Annual Improvements project, the amendment to paragraph 83 of IAS 19 as proposed and without performing further analysis on this issue? 2. Does the IASB agree with the Interpretations Committee's recommendation that the amendment should be applied from the beginning of the earliest comparative period presented in the first financial statements in which the entity applies the amendment, with any cumulative catch-up adjustment recognised in opening retained earnings?

Appendix A—Interpretations Committee criteria for annual improvements

A1. Our assessment of the issue against the annual improvements 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 existing IFRSs and the *Conceptual Framework for Financial Reporting*.	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.
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.
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”.

In addition to the implementation and maintenance criteria, an AIP should (6.11, 6.12):	
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 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.