

International Financial Reporting Standards



Discount rates – review of existing requirements

Project overview

ASAF - Sep 2014

AP02

The views expressed in this presentation are those of the presenter, not necessarily those of the IASB or IFRS Foundation.

Objectives of the session

- Introduce research project on discount rates;
- Obtain feedback on the approach;
- Obtain suggestions for areas to focus on in conducting the review.

- Standards requiring present value measurement techniques, except for fair value:
 - IAS 19 *Employee Benefits*
 - IAS 36 *Impairment of Assets*
 - IAS 37 *Provisions, Contingent Liabilities and Contingent Assets*
 - IFRS 9 *Financial Instruments*
- Interaction with other projects:
 - Active projects (eg Insurance and Leases)
 - Conceptual Framework
 - Research projects on rate regulation, employee benefits
 - Relevant IFRS IC projects

Aspects under consideration

- Measurement objective;
- Discount rate components;
- Measurement methodology;
- Disclosure requirements;
- Terms and definitions.

Aspect: Measurement objective

- Is measurement objective in a Standard clear?
- Are present value techniques applied in that Standard in a way consistent with the stated measurement objective:
 - In drafting?
 - In practice?

Aspect: Components of present value measurement

- All present value measurements include:
 - Future cash flows*;
 - Time value of money ('risk-free rate');
- Some present value measurements also reflect:
 - Risk that cash flows may be different (risk premium);
 - Risk of default (non-performance risk);
 - Market liquidity risk (liquidity premium);
 - Profit margin
 - Other cash flows, such as transaction costs.

* Uncertainties in amount or timing of future cash flows are dealt with techniques including central estimates (such as expected value, mode or median) and maximum or minimum

Components of PVM – preliminary findings

IFRS / Project	Item measured	Measurement description	Rate description (if applicable)	Time value of money	Risk premium	Liquidity premium	Own non-performance risk
IFRS 13	Assets and liabilities at fair value	Fair value		Yes	Yes	Yes	Yes
IAS 36	Non-financial assets (impairment)	Value in use		Yes	Yes	Yes	n/a
Leases	Lease liability	Present value of future lease payments	Rate implicit in lease (Note 1)	As charged by lessor	As charged by lessor	As charged by lessor	As charged by lessor
			Incremental borrowing rate (Note 2)	Not explicit	Not explicit	Not explicit	Not explicit
Leases	Lease receivable	Net investment in lease	Rate implicit in lease (Note 1)	As charged by lessor	As charged by lessor	As charged by lessor	As charged by lessor
IFRS 9	Financial assets measured at amortised cost	Amortised cost	Effective interest rate (Note 3)	Yes	Yes	Yes	n/a
IFRS 9	Financial liabilities measured at amortised cost	Amortised cost	Effective interest rate (Note 3)	Yes	Yes	Yes	Yes
IFRS 9 [impairment]	Expected credit loss allowance ^a	Expected credit loss	Original effective interest rate (see above) or approximation thereof				
Insurance contracts	Insurance contract ^b (Note 4)	Present value of net cash flows expected to fulfil		Yes	Yes (separate)	Yes	No
IAS 37	Provisions	The amount to settle or transfer		Yes	Implicit	Not explicit	Not explicit (in practice no)
IAS 19	Defined benefit plan obligation	Present value of ultimate cost		Yes	No	Some (Note 5)	Some (Note 5)

^a Or a provision, ^b Liability or an asset

Notes to components of PVM table

1 - The rate implicit in lease is a calculation and does not refer to individual components, also includes lessor's initial direct costs not mentioned in the table.

2 - The guidance about incremental borrowing rate refers to a rate that would be paid by the lessee on a similar asset, without referring to specific components.

3 - The effective interest rate is a calculation which also includes eligible fees and expenses not mentioned in the table.

4 - Includes both a cash flow component and a contractual service margin (CSM). The table does not mention the CSM.

5 – Included to the extent these are included in the rate of bonds used, the components are not entity-specific.

- Rate observed, built (bottom-up or top-bottom) or calculated;
- Detail of guidance included in the Standard;
- Entity vs market perspective; in cash flows and in the rate;
- Pre-tax or post-tax and inflation;
- Adjustments to the cash flows or the rate.

Aspect: Disclosures

- Not all Standards require discount rate disclosure; common practice developed for some;
- Findings to feed into Disclosure Initiative.

Aspect: Terms and definitions

- Which terms are most commonly used; which are defined;
- Are they used consistently (eg time value of money);
- Is any inconsistency causing issues in practice.

- Mainly desktop study of IFRSs;
- Limited academic literature and IFRS guidance;
- Meetings with a few stakeholders;
- No advisory group at this stage.

- External
 - Investors and analysts
 - Actuaries and valuation professionals
 - Preparers and auditors
 - Regulators
 - Academics
 - Both developed and emerging markets
- Internal
 - Project teams that work on measurement

- Tentative plan to issue a Research Paper
- Then, a number of options:
 - No further action;
 - More research on specific issues identified;
 - Add one or more projects to the active agenda:
 - Narrow-scope improvements;
 - Prepare guidance and embed in the Conceptual Framework;
 - Stand-alone Standard on discounting.
- Options not mutually exclusive

Questions for ASAF

1. Do you have questions or comments on the approach to the discount rates research project?
2. Do you have suggestions for potential areas of inconsistency to focus on when conducting the review?

Next steps

- Continue work on review – preliminary research paper in Q4 2014
- Limited outreach in progress