

STAFF PAPER

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IASB Meeting

Project	Present value measurements – discount rates research		
Paper topic	Summary of findings and the next steps		
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Introduction

1. We use present value measurement techniques to reflect the time value of money. Present value measurement translates a sum of money to be held at a future date (a future value) into an equivalent in terms of money held today (a present value).
2. Present value measurement techniques are widely used in IFRS, as a means to determine both fair value and a number of other, entity-specific, measurements. As a result, different Standards require or allow different discount rates to be used. Views received during the IASB's 2011 Agenda Consultation suggest that the reasons for using different discount rates are not well understood, with some respondents suggesting that such differences cause IFRS requirements to be inconsistent.
3. Responding to these views, the IASB has conducted a research project to examine the IFRS requirements on present value measurement and on discount rates to identify why those differences exist and to assess whether there are any unjustified inconsistencies that the IASB should consider addressing.
4. The paper has two sections:
 - (a) Overall findings; this includes a summary of inconsistencies identified that, in staff's opinion, could pose financial reporting problems and the possible approaches to addressing them. (The accompanying draft Research Paper discusses the findings in detail) We do not ask the IASB any specific

questions on our overall findings but will invite comments and questions on this section.

- (b) Immediate next steps. In this section we propose to publish a Research Paper asking for respondents' views on whether the issues identified cause problems in practice. We ask the IASB for approval for publishing the Research Paper as proposed. There are three separate questions for the IASB.

Overall findings

5. Present value measurement techniques can be used in applying various measurement bases. IFRS uses a mixed-measurement model and thus the use of different discount rates (and different cash flows) for different measurements is justified. For example, historical cost measurement would use a historical discount rate and historical estimates of the cash flows (to the extent that the carrying amount is recoverable), whereas current value measurement would use current inputs for all factors (such as discount rates and cash flows).
6. However, some differences are more difficult to explain. For example, why is the effect of the time value of money ignored in some cash-flow based measurements? Why is there no explicit measurement basis in some Standards that use entity-specific measurements? Why is each entity-specific measurement somewhat different from other entity-specific measurements? Why is it not always clear which components those entity-specific measurements include? Why are presentation and disclosure requirements for entity-specific present value measurements different? Why does IFRS prescribe a particular present value measurement method for some entity-specific measurements when other methods could achieve the same outcome and could be easier to apply?
7. Many of these questions can be summed up in one overarching question—there is one fair value in IFRS, applied in various Standards, but arrived at using the same set of acceptable methods, accompanied by the same set of disclosure requirements; to what extent would it be possible and desirable to seek to apply similar consistency for entity-specific current value measurements?

8. We do not think that many of the inconsistencies are intentional; rather, they seem to be a product of developing Standards independently of each other and at different times. The inconsistencies are somewhat comparable to inconsistencies in how fair value was used in different Standards before IFRS 13 *Fair Value Measurement* was developed.
9. Working for fully consistent requirements for current entity-specific measurements such as those currently existing for fair value would be an opportunity to achieve a level of consistency in financial reporting that has not been possible thus far.
10. We note that the *Conceptual Framework* Exposure Draft already describes what an entity-specific measurement is (paragraph 6.35), but also indicates that the IASB might wish to customise it in particular Standards (also in paragraph 6.35). When the IASB finalises the *Conceptual Framework*, it will decide whether to retain entity-specific measurements, how to define them and whether to permit customisation. We have therefore not considered the overarching question in paragraph 7 as a part of this research.
11. The table on the page 5 lists the specific issues we have identified in this research project, their implications and the possible approaches to addressing them.
12. In the table we have grouped issues by areas by which the research was organised, namely:
 - (a) Scope of present value measurement: here we considered when present value measurement is used in IFRS and when it is not, but could be;
 - (b) Measurement basis: here we considered whether the measurement basis for each current entity-specific present value measurement is clear;
 - (c) Present value measurement components: here we considered whether it is clear which components are included in a particular present value measurement, and whether the components included are consistent with the measurement objective (if there is one) and with other Standards that have the same measurement objective;
 - (d) Present value measurement methodology: here we considered whether there is consistency in methods required or allowed to be used when arriving at a

present value measurement. In particular, we considered how risk, inflation and tax are reflected. We also considered use of entity vs market perspective in measurement; and

- (e) Present value measurement presentation and disclosures; in these two sections we considered whether there is consistency in requirements for how the impact of present value measurement is presented in reporting financial performance and whether there is consistency in disclosure requirements.

Issue no	Research area	Description of the potential financial reporting problem	Consequence of not addressing the problem	Potential solutions			
				Conceptual Framework	Individual Standard(s)	Cross-cutting standard-setting	Education
1	Use of present value	Relationship between present value measurement and historical cost measurement basis not explored	No principle for time value of money in cost-based measurements, lack of comparability of financial and non-financial assets at cost	✓			
2	Use of present value	Discounting of deferred taxes not permitted	Lack of comparability, goodwill overstated/understated	✓	✓		
3	Measurement basis	IAS 19 lacking measurement objective	Application of Standard limited to the set of circumstances covered by rules, any change prompts calls for further rules	✓	✓		
4	Measurement basis	IAS 19 measurement reflects credit risk of third parties, dual rates used	Rate used not relevant in all aspects to liability measured, lack of comparability	✓	✓		
5	Measurement basis	IAS 37 measurement objective unclear	Different understanding of objectives could lead to inconsistent measurement	✓	✓		
6	Components	Application of entity-specific perspective in measurement	Value in use hard to audit and enforce and some say not relevant	✓	✓	✓	
7	Components	Liquidity risk not consistently reflected in entity-specific measurements	Loss of comparability, eg pensions and provisions versus insurance liabilities.	✓	✓	✓	
8	Methodology	Pre-tax and post-tax meaning and conversion	Errors in conversion and interpretation lead to misstatements			✓	✓
9	Methodology	Allowing only a particular method, eg pre-tax inputs requirement for value in use in IAS 36	Additional complexity, potential misstatements		✓	✓	
10	Methodology	Mixed use of entity and market perspective in accounting for tax	Overstatement of deferred tax balances		✓	✓	✓
11	Presentation	Inconsistent use of OCI vs profit or loss in reassessment	Lack of comparability, unclear meaning of profit or loss	✓	✓	✓	✓
12	Disclosure	Inconsistent disclosure requirements; rate(s) & method used, impact on P&L and sensitivity analysis	Lack of comparability and insight in judgements made in measurement		✓	✓	

Table 1 List of potential financial reporting problems identified in research on present value measurements–discount rates

13. As discussed in the following paragraphs, the approach to finding and implementing solutions to the issues identified would depend on the issue.
14. The IASB's existing project on the Conceptual Framework is a starting point for resolving the issues listed relating to the measurement basis, components and possibly also the presentation of present value measurements. Once the Conceptual Framework's material on those topics is complete, the IASB will be better placed to consider how best to define and align measurement bases when working on existing individual Standards. Therefore, any standard-setting action relating to the measurement basis and to measurement components needs to be informed by the new Conceptual Framework and could be done most effectively after the Conceptual Framework is in place.
15. The Conceptual Framework work will also be important in aiding consistency of future standard-setting on present value measurements, for example, when the IASB decides on measurement requirements for rate-regulated activities and pollutant pricing mechanisms.
16. That material could also help preparers and others when they need to address some issues not covered explicitly by Standards, for example whether to reflect time value of money in prepayments made and it would also provide clearer context for the application of existing present value measurement requirements.
17. For the Conceptual Framework to be most useful in addressing the issues identified in this research, in our view it has to explain the role of time value of money in measurement, describe the available measurement bases and their components and provide clear guidance on the use of Other Comprehensive Income.
18. The issues identified relating to the present value methodology and disclosure are too detailed to be addressed by the Framework and therefore do not need to wait for it to be completed. For some of those issues, just providing educational material explaining the existing requirements may be sufficient (for example, this could be the case if the IASB wishes to explain how pre-tax and post-tax inputs interact).
19. Consequently, we think that simply publishing our findings will go some way towards promoting understanding of present value measurements and will increase consistency in their uses.

Next steps on the research project

Case for a Research Paper

20. According to the IFRS Foundation *Due Process Handbook*, the output of a research project is either a Discussion Paper or a Research Paper. Also, a Request for Information can be issued.
21. Research Papers are generally prepared by technical staff and need not include the IASB views on the matters discussed. A simple majority of the IASB members needs to give approval in a public meeting before it is published. The process for publishing a Request for Information is the same.
22. Discussion Papers include analysis and collective views of the IASB on a particular topic. Therefore, in order to issue a Discussion Paper on discount rates research, the IASB would need to discuss and reach views on the topics discussed in this paper. A Discussion Paper is balloted by the IASB.
23. The IASB may wish to wait until it completes work on the Conceptual Framework before it reaches preliminary views on some of the issues identified in this research, such as on measurement basis and measurement components. Also, the IASB has separate research projects on each of the Standards reviewed in this research¹. Therefore, the IASB may not wish, in this project, to have the detailed discussion it would need to reach preliminary views on the issues identified.
24. However, we think that issuing a cross-cutting document at this stage covering all findings from the discount rates research would be beneficial for stakeholders, regardless of whether the IASB expresses preliminary views on the issues identified.
25. Staff therefore recommend publishing a Research Paper to document the findings. In our view, this would help inform and educate stakeholders and be useful as an internal resource guide, regardless of what next steps the IASB decides to take. The Research Paper would not include the IASB's preliminary views on the issues identified.

¹ Separate research projects on IAS 19, IAS 36, IAS 37, IAS 12 are all ongoing at this moment.

Question 1

Does the IASB agree to publish a research paper with the findings as the next step on discount rates research? The Research Paper would not include the IASB's preliminary views on the issues identified. If not, what does the IASB suggest as the next step and why?

Should there be a Request for Views too?

26. If the IASB agrees to publish a Research Paper, the next question to consider is whether the document should request views from respondents.
27. The Due Process Handbook does not specify whether Research Papers should request views. Including questions in the document could result in more focussed feedback.
28. One issue to consider is whether the questions would create an overlap with the IASB's Agenda Consultation. We do not think this is likely because the Agenda Consultation asks only for views on what should be on the research programme and not about the way forward on the items already on the research agenda, such as present value measurements research.
29. We therefore recommend asking for respondents' views. This will provide the IASB with feedback before it decides whether it should take any further action to address any of the issues identified in this research. That action might include any of the following, for some or all of the issues identified:
 - (a) carry out further research to investigate possible solutions to some or all of the issues. After carrying out such research, the IASB would consider whether to add to its work plan one or more projects to implement the solutions. Such projects could involve amendments to one or more existing Standards, or developing a new cross-cutting Standard;
 - (b) develop proposals for narrow-scope amendments to one or more existing Standards to address one or more of the issues;
 - (c) address one or more of the issues within the context of projects on individual Standards. For example, the IASB could consider the discount rate for pensions in a research project on post-employment benefits (either

its existing research project on that subject, or a subsequent Standards-level project, if the IASB decides to do such a project);

- (d) develop educational material or guides; or
 - (e) take no further action.
30. As the focus of the Research Paper is on identifying problems in financial reporting, respondents would be asked for views on whether the issues identified cause problems that need to be addressed by the IASB any further. A draft list of proposed questions is included in Appendix 1.
31. Assuming the IASB agrees to publish a Research Paper without its preliminary views, we do not think the paper should ask the respondents for views on how to address the identified issues, for example there would be no questions concerning next steps, such as those listed in paragraph 29.

Question 2

Does the IASB agree that published paper should request views from stakeholders on whether the issues identified cause problems that should be addressed by the IASB? If not, what does the IASB suggest instead, and why?

Should any further work be done at this stage?

32. If the IASB agrees to issue a Research Paper, the Board members will have an opportunity to see the final draft of the Research Paper before it is published. The first draft of the proposed Research Paper is included in the papers provided for this meeting. The following sections briefly discuss the scope of the work, methodology and the content of the proposed Research Paper.

Scope of research

33. The research considered the following aspects of present value measurement in IFRS, briefly described in paragraph 12:
- (a) Scope of present value measurement in IFRS;
 - (b) Measurement basis;

- (c) Present value measurement components;
- (d) Measurement methodology;
- (e) Impact of present value measurement on performance reporting; and
- (f) Present value measurement related disclosures.

34. When reviewing the scope of present value measurement we considered all instances where present value measurement technique is currently used in IFRS, as well as where it is not used, but could be. The review of measurement bases started by considering all measurement bases in IFRS but the detailed review focussed on current entity-specific present value measurements in IFRS, which is where the issues arise. Therefore this, and the remaining parts of the research focussed on the review of the following Standards:

- (a) IAS 19 *Employee Benefits*
- (b) IAS 36 *Impairment of Assets*
- (c) IAS 37 *Provisions, Contingent Liabilities and Contingent Assets*

In conducting the work, we also made references to requirements in IFRS 13 as well as the proposals in the Insurance Contracts project.

Research methodology

35. The research was mainly a desktop study of IFRS requirements. We also conducted limited outreach with key stakeholders, including investors, preparers, regulators, auditors, actuaries and valuation professionals. We have also done limited empirical research to help us assess whether the issues identified presented financial reporting problems. We have focussed our empirical research in areas where we could obtain information relatively easily, for example where we could extract information from data aggregators or where research was already available or could be obtained easily.

Content of research paper

36. The Research Paper is set out in sections organised by the main aspects of present value measurement, as listed in paragraph 33 above. For each aspect reviewed, we have broadly organised the discussion as follows:

- (a) review and comparison of current IFRS requirements;

- (b) any empirical findings; and
 - (c) potential inconsistencies identified and their consequences.
37. The Research Paper does not include staff recommendations for addressing the problems identified. We think it would be premature to include recommendations on how to solve the problems before seeking public feedback on whether the issues identified pose financial reporting problems that need to be resolved at all.

Question 3

- a) Does the IASB think the staff have performed sufficient work for this stage of research? If not, what additional work do you think should be performed at this stage and why?
- b) Does the IASB have any comments on the content and structure of the Research Paper?

Appendix 1 – Draft list of proposed questions for the Request for Views

- A1. The Staff proposes including the following questions in the Request for Views accompanying IFRS Present Value Measurements Research Paper:
- 1) Do you think the issues identified in the Research Paper pose financial reporting problems? If so, which issues pose problems, and why?
 - 2) What are the consequences for you if these problems are not addressed?
 - 3) Which of the issues do you think the IASB should address? If you do not think the IASB should address these issues, how do you think they should be addressed?
 - 4) Are there any financial reporting problems relating to present value measurements not mentioned in the Research Paper that you think the IASB should address? If so, which ones and why?