

## STAFF PAPER

April 2016

## Board Meeting

<b>Project</b>	<b>Present value measurements—discount rates</b>		
<b>Paper topic</b>	2015 Agenda Consultation Feedback		
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This paper has been prepared for discussion at a public meeting of the International Accounting Standards Board® (“the Board”) and does not represent the views of the Board or any individual member of the Board. Comments on the application of IFRS® Standards do not purport to set out acceptable or unacceptable application of IFRS Standards. Technical decisions are made in public and reported in IASB *Update*.

## Introduction

1. This paper summarises feedback received on the discount rates research project in the International Accounting Standards Board’s (the Board) Request for Views 2015 *Agenda Consultation*. There are no questions for the Board in the paper.
2. The paper includes the following sections:
  - (a) high-level summary of the feedback;
  - (b) project background and work done so far;
  - (c) comments on objective and scope of the project;
  - (d) who thinks the project is important and why?
  - (e) who thinks the project is not important and why?
  - (f) comments on timing and interaction with other projects;
  - (g) appendix with tables analysing responses by stakeholder types and regions.
3. At a future meeting, we plan to ask the Board:
  - (a) to complete outstanding discussion of research findings, possibly including risk adjustment and interaction of discount rates with taxes.
  - (b) what it would like to do with staff findings so far, ie what steps it wants to take next in the project.

## High-level feedback summary

4. Overall, from 119 comment letters received in the Agenda Consultation, 67<sup>1</sup> rated the importance and urgency of discount rates research. Twenty-nine respondents gave the project high importance ratings and 28 gave it medium ratings. The remaining 10 thought the project was of low importance.
5. The urgency ratings were similar, although a slightly smaller proportion of respondents rated the project as of high or medium urgency.
6. Forty-seven of 67 respondents who rated the project also made project-specific comments. About 40 of respondents who made project-specific comments gave the research medium or high importance rating and the remaining 7 gave a low-importance rating. The comments recognised the pervasive nature of present value measurement and the impact of discount rates on financial reporting. Respondents also noted inconsistencies in requirements for discount rates in IFRS Standards, though not all thought the inconsistencies needed addressing.
7. While many respondents asked the Board to address inconsistencies, suggestions for solutions varied. Some respondents suggested that the work done should be used to inform the Board and aid future standard-setting or to develop a Practice Statement, rather than create new standards now. Others suggested the Board amend individual standards or develop comprehensive guidance for present value measurements. A few respondents thought work on discount rates should stop, either because they did not think there were significant problems or because they thought the work should be done on individual Standards, and not as a part of a cross-cutting project. Several commentators noted the link between work on discount rates and the Conceptual Framework, with some suggesting this project should be a part of the work on the Framework, which currently does not have a section on discount rates.
8. The levels of response and support for Board to work on discount rates were similar to those on the Board's previous *2011 Agenda Consultation*, but this time respondents provided little more detail behind the views presented. Still, many respondents made

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<sup>1</sup> Including two implied ratings, one for an audit firm and for global securities regulator, plus a rating carried over from 2011 agenda consultation for global investors forum.

generic comments about inconsistencies to be resolved, without making references to, or possibly not being aware of, the research work done so far<sup>2</sup>.

### **Project background and work done so far**

9. The research project on discount rates was initiated following the Board's *2011 Agenda Consultation*, when respondents suggested that the reasons for using different discount rates in IFRS Standards are not well understood. Some respondents suggested that such differences create inconsistencies in requirements in IFRS Standards.
10. The objective of the research project is to examine discount rate requirements in IFRS Standards and assess whether there are any inconsistencies the Board should address. In June 2014, the Board discussed the scope of research and decided to ask the staff to look at the following aspects of present value measurements:
  - (a) when is present-value measurement used in IFRS Standards;
  - (b) measurement objectives;
  - (c) discount rate components;
  - (d) measurement methodology; and
  - (e) presentation and disclosure.
11. The staff identified a number of differences in present value measurement requirements in IFRS Standards. Some of the differences could be explained by differences in measurement objectives and some did not seem to cause inconsistencies in practice. However, several differences could not be explained, partly because measurement objectives were unstated or unclear. The research also highlighted some inconsistencies in requirements for when to use present value measurement—which measurement method to use and what to disclose relating to discount rates and present value measurement.
12. The staff findings were presented and discussed with the Board in meetings from September 2015 until January 2016 (AP17, January 2016). Papers presented at those

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<sup>2</sup> The Request for Views did not make specific references to work done on the project so far.

meetings also included a summary of comment letter feedback from the *2011 Agenda Consultation* as well as a summary of submissions to the IFRS Interpretations Committee relating to discount rates. These are not repeated in this paper.

13. The Board has not decided what it wants to do with staff findings from the project. The Board's initial discussion of findings revealed areas needing further discussion/clarification, including the relationship between tax and the rates. These will be discussed at a later meeting.

### **Comments on objectives and scope of the project**

14. A few respondents referred explicitly to the work done on discount rates research so far and to the findings documented in papers presented to the Board. It is not clear whether other respondents who commented on this project were aware of the work done so far.
15. From 47 comment letters with specific discussion on discount rates research, about a dozen included discussion on the scope and objectives of the project. Several respondents stated or implied that the current scope of the project was appropriate. One respondent encouraged the Board to complete existing project and 'collate data necessary to enable constituents to form an opinion on whether it should be taken further' (CL#50).
16. There was a range of other views from suggestions to focus on activities other than standard-setting guidance to setting up two standard-setting streams.
17. The following extract from an auditor's comment letter suggests work rather than immediate standard setting, and the Australian standard-setter made a similar comment (CL#38):

We know, and agree, that not all research projects will lead to standard-setting activity. Some might lead to an amendment of the Conceptual Framework or the development of a resource that could be used to assist the Board (and the Interpretations Committee) in standards-level projects. For example, we think that the research activity on Discount Rates could help the Board understand which discount rates are

most appropriate to a particular measurement objective, so that consistent decisions can be made over time. (CL#89)

18. One respondent from Latin America suggested developing a Practice Statement on present value measurement could be a way forward.

19. Another auditor suggested the research should lead to two standard-setting streams:

Due to the current low interest environment, it may be that interest rates are or become negative. In practice, this leads to challenges on how to deal with risks in a low (or negative) interest environment, for example, for provisions. The practical problems should be dealt with sooner than the more conceptual concerns addressed below.

Discount rates vary widely across different standards, which leads to conceptual problems. In order to be high quality standards, internal consistency and a consistent underlying principle are essential. (CL#41)

20. A few other respondents also suggested dividing the project in streams. For example, a securities regulator suggested reassessing discount rate requirements in individual standards, and developing a separate standard on the mechanics of present-value measurement techniques (CL#11). An accounting body suggested a large cross-cutting project that would include one stream that researches differences in rates and their effects, and a second stream that looks at accounting for and presenting changes in discount rates (CL#107).

### **Who thinks this project is important and why?**

21. As noted in the high-level summary, nearly half of all comment letters received rate the project as of high or medium importance. Analysis of support by types of stakeholders and regions along with the reasons provided is in the following subsections.

### ***Views by type of stakeholder***

22. Standard-setters and regulators were the strongest supporters of working on discount rates, with the vast majority of respondents<sup>3</sup> in these categories stating the project was important. However, notably, neither IOSCO nor the Japanese standard-setter thought the project was a priority (see discussion on the reasons for their low ratings in the next section).
23. Many standard-setters said their reason for rating the project as important was the current inconsistency between IFRS Standards, which means the quality of the IFRS Standards is not as high as it could be and the comparability is undermined.
24. Other reasons standard-setters gave for working on this project included:
  - (a) pervasive and cross-cutting issues, particularly important in some industries;
  - (b) practical issues in some jurisdictions (Brazil was specifically mentioned).
25. The reasons regulators gave in support of working on this project included:
  - (a) the current implementation and consistency challenges;
  - (b) the lack of connections between measurement objectives and discount rates in some IFRS Standards; and
  - (c) the significant impact of discount rates on financial statements.
26. Auditors generally stated that the research done so far was worthwhile, though they were about evenly split on their project importance ratings and a few did not rate<sup>4</sup> the project at all. A few saw discount-rates as an important project that required standard-setting; a few thought the work done should be used to inform the Board's thinking about other projects; and a few did not think there were significant issues worth working on. Auditors who supported further work on the project gave the following reasons for it:
  - (a) uncertainty over which discount rate methodology to apply;

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<sup>3</sup> Total number of all comment letters including those who have not commented on the project specifically

<sup>4</sup> This includes a global audit firm which has only said the work on discount rates should be 'linked' to the Conceptual Framework.

- (b) the lack of the consistency needed in high-quality standards; and
  - (c) the need to help the Board make consistent decisions over time.
27. A third of preparer respondents (12 out of 36) specifically identified this project as of high (6) or medium (6) importance. They gave the following reasons for supporting work on this topic:
- (a) pervasive use of discount rates;
  - (b) diversity of guidance in IFRS Standards, making it hard to apply and explain to investors;
  - (c) a principles-based approach, rather than a rules-based approach, is needed; and
  - (d) some practical methodology considerations need to be addressed, such as pre- and post-tax rates.
28. Ten of 12 user respondents only commented on their top 3 or 4 priority projects,<sup>5</sup> and discount rates was not one of them (one of 86 users who responded to the separate online agenda survey stated that discount rates was one of their top three priority projects – see below).
29. The CRUF Global was one of ten investors who emphasised their priority project (performance reporting). However, in their comment letter they also referred to their response to 2011 Agenda Consultation being still valid. In this letter they gave discount rates high rating (with a note that this the high rating applied to the discount rates for insurance, financial instruments and pensions and work discount rates for other areas was of low priority).
30. Two more users rated discount rates discount rates research in their comment letters, both assigning it high importance and urgency—the CFA Institute and Eumedion. They each gave different reasons for the high rating, including:
- (a) conceptual issues and inconsistencies, for example, whether to include only time value of money and risks, and when this would be appropriate;

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<sup>5</sup> 3 CLs from users discuss one project only.

- (b) breadth of impact across Standards— rates have significant bearing on measurement principles and forward-looking information and therefore are very important to investors; and
  - (c) specific problem - why future salary rises are included in IAS 19 measurement, which was not seen as representing a present obligation; and
  - (d) emerging issues, such as low and negative interest rates.
31. Over half of the investors who responded to the separate online agenda survey (ie 48 out of total of 86) assigned discount rates high (18) or medium (30) priority. 15 of them made specific comments<sup>6</sup>. The comments did not have an overlapping theme, but covered a range of reasons for the importance ratings, including:
- (a) discount rates used opportunistically, including to manage debt;
  - (b) specific problem relating to IAS 19 *Employee Benefits*— currently there is a very wide margin between rate of salary increases and interest rates. Also, there's a wide margin between return on capital and time value of money;
  - (c) IFRS Standards should have the same approach to similar items; and
  - (d) the Board should address whether own credit should be relevant for measurement of any liabilities.
32. From users responding to the online agenda survey, one stated that discount rates is one of the three areas he or she would most like the Board to improve, because it is a cross-cutting issue. This was a buy-side, advanced user of financial statements, covering Europe and North America. In addition to discount rates, this user also wanted to see improvements in performance reporting and cash-flow statements.
33. A table analysing comment letter responses by stakeholder types is in the appendix.

### **Views by regions**

34. Respondents from Oceania and Latin America overwhelmingly supported carrying out research on discount rates. Nine of 11 respondents from these two regions ranked

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<sup>6</sup> Mixed between those who assigned high or medium importance. Some comments supporting medium importance



the importance and urgency of this project as either high or medium. The respondents from Oceania mostly quoted pervasiveness and need for consistency as the reasons for high ranking whilst those from Latin America tended to focus on practical issues and methodology.

35. Carrying out research on this topic received healthy support from Europe, North America and Africa as well. From 73 respondents in total, 37 rated it as either of high or medium importance, three rated it as of low importance, and 33 did not rate it. The reasons many of these respondents gave for project importance were similar as in Oceania, ie pervasiveness and need for consistency.
36. The topic received little support from Asia, with no 'high importance' rankings from 21 respondents. Digging a bit deeper however, the only explicit 'low' rankings from Asia were given by Japanese respondents (respondents from Japan either provided no rating or rated the projects as of low importance). Other Asian respondents who rated the project ranked it as of medium importance, including those from Korea, India, and Hong Kong, as well as from the regional standard-setters group. We did not find any arguments in the comment letters to be specific to Asia or Japan– the reason mentioned by those not supporting the project was that there are no significant issues to resolve.
37. A table analysing responses by region is included in the appendix.

### **Who thinks this project is not important and why?**

38. Ten<sup>7</sup> respondents ranked the project as of low importance. They included three respondents from Japan, three<sup>8</sup> global audit firms and IOSCO<sup>9</sup>. Seven of those respondents provided reasons for the low ranking, summarised in three main reasons:
  - (a) there are no significant issues with current guidance;
  - (b) the Board should continue the work, but as part of the work on the Conceptual Framework, or in projects on individual standards; and

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<sup>7</sup> Including two implicit rankings

<sup>8</sup> One of the audit firms ranked the project as of low importance only implicitly; in their comment letter they listed the projects they wanted the Board to prioritise, and this list did not include discount rates.

<sup>9</sup> IOSCO did not specifically rate the project importance but described it as 'lower priority'.

- (c) the Board should make room for more pressing areas where there are gaps in guidance.
39. Respondents from Japan mainly quoted the first reason above as explanation of their low ranking, IOSCO cited the need to make room for areas where guidance is insufficient, whereas the three audit firms and others quoted all three reasons mentioned above.
40. Looking at stakeholder types, there was not a stakeholder category where a majority was not supporting work on the project. However, auditors and preparers are two types of stakeholder which had expressed least support for research on discount rates.
41. As noted above, auditors were quite split in views on whether to do further work on discount rates, with three out of 10 audit firms responding rated the project as of low importance (two each have rated it as of high/medium importance respectively). With regards to preparers, while only 5 per cent of preparers explicitly rated the project as being of low importance, also a relatively small proportion—a third—rated it as of high or medium importance. Two of the three preparers who rated the project as of low importance provided comments saying they did not think there were significant issues with discount rates that needed resolving.
42. There were no users who, in their comment letters, specifically ranked the discount rates as low importance project. As noted earlier though 10 out of 12 users who sent comment letters specified their top priority project(s) which did not include discount rates. Also, eighteen users who responded to the separate online agenda survey, out of total of 86 survey respondents, assigned discount rates low priority. Two of those made specific comments:
- (a) the subject is theoretical and subjective; and
  - (b) disclosure of which rate is used and how it is arrived at, along with sensitivity analysis, should be sufficient<sup>10</sup>.

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<sup>10</sup> In the research, the staff noted that the disclosures mentioned are currently not required for all present value measurements in IFRS Standards.

## Timing and links to other projects

### *Timing*

43. From 57 respondents who rated the project as of either high or medium importance, 46 rated the urgency of the project the same as its importance. Six respondents rated the urgency level one notch lower than that of importance, with two separate reasons offered—the long time such a project would take and the lack of an urgent need for change.
44. Four respondents who gave the project high or medium importance rating gave no specific rating for the urgency. The remaining respondent rated the project urgency higher than importance, perhaps by accident.
45. From 10 respondents who rated the project as of low importance, seven rated its urgency low as well. Two respondents' low importance rating was only implicit and as such there was no specific rating for urgency. Another respondent rated urgency as medium, perhaps by accident.

### *Links to other projects*

46. Several respondents commented that the work on discount rates was linked to the *Conceptual Framework*, with a couple suggesting that any further work on discount rates should be done as a part of the *Framework* project, noting that the *Framework* Exposure Draft did not include a discussion on discount rates.
47. Because the discount rates project is cross cutting, several respondents recognised links to work on other Standards that require use of present value measurements. In particular, respondents mentioned IAS 37 *Provisions, Contingent Liabilities and Contingent Assets* and IAS 19 *Employee Benefits*. A couple of respondents suggested that any further work should be done as a part of work on individual standards, and not as a cross-cutting project. A couple of other respondents, however, suggested the Board continue the cross-cutting project on discount rates and the work on individual standards, such as IAS 37, as well as the current work on goodwill and impairment.

**Appendix —Comment letter analysis in numbers by stakeholder types and regions**

Stakeholder type	High importance	Medium importance	Low importance	No rating	Total
Preparers and industry organisations	6	6	2	22	36
Standard-setters	10	9	2	5	26
<b>Accountancy firms and accountancy bodies</b>					
Accountancy firms	2	2	3	3	10
Accountancy bodies	2	7	2	5	16
Users	3	0	0	9	12
Others	2	1	0	7	10
Regulators and government agencies	4	3	1	1	9
<b>Total</b>	<b>29</b>	<b>28</b>	<b>10</b>	<b>52</b>	<b>119</b>

*Table 1 Comment letter importance ratings by stakeholder types in numbers*

Stakeholder type	High importance	Medium importance	Low importance	No rating	Total
Preparers and industry organisations	17%	17%	5%	61%	100%
Standard-setters	38%	35%	8%	19%	100%
<b>Accountancy firms and accountancy bodies</b>					
Accountancy firms	20%	20%	30%	30%	100%
Accountancy bodies	13%	44%	13%	31%	100%
Users	25%	0%	0%	75%	100%
Others	20%	10%	0%	70%	100%
Regulators and government agencies	44%	33%	11%	11%	100%
<b>Total</b>	<b>24%</b>	<b>24%</b>	<b>8%</b>	<b>44%</b>	<b>100%</b>

*Table 2 Comment letter importance ratings by stakeholder types in percentages*

	High	Medium	Low	No rating	Total
<b>Africa</b>	0	3	1	0	<b>4</b>
<b>Asia</b>	0	7	3	11	<b>21</b>
<b>Europe</b>	18	11	1	29	<b>59</b>
<b>Latin America</b>	3	1	0	1	<b>5</b>
<b>North America</b>	3	2	1	4	<b>10</b>
<b>Oceania</b>	3	2	0	1	<b>6</b>
<b>Global</b>	2	2	4	6	<b>14</b>
<b>Total</b>	<b>29</b>	<b>28</b>	<b>10</b>	<b>52</b>	<b>119</b>

**Table 3 Comment letter importance ratings by regions in numbers**

	High	Medium	Low	No rating	Total
<b>Africa</b>	0%	75%	25%	0%	100%
<b>Asia</b>	0%	33%	14%	52%	100%
<b>Europe</b>	31%	19%	2%	49%	100%
<b>Latin America</b>	60%	20%	0%	20%	100%
<b>North America</b>	30%	20%	10%	40%	100%
<b>Oceania</b>	50%	33%	0%	17%	100%
<b>Global</b>	14%	14%	29%	43%	100%
<b>Total</b>	<b>24%</b>	<b>24%</b>	<b>8%</b>	<b>44%</b>	<b>100%</b>

**Table 4 Comment letter importance ratings by regions in percentages**