STAFF PAPER

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Project	**Discount rates**		
Paper topic	Update on the discount rates project		
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The purpose of the session

1. Agenda Paper 1 *Technical Activities: Update* includes high level overview of the discount rate project. This paper includes more detailed update on the project status and its findings.

Background

2. IFRS Standards written over the years have required different discount rates to be used in different IFRS measurements. The Board instructed staff to conduct a research project with the objective of examining discount rate requirements in IFRS Standards to identify why those differences exist and assess whether there are any unjustified inconsistencies that the Board should consider addressing.

3. The staff conducted the research in 2014 and 2015 and the Board considered the findings between September 2015 and January 2016. Staff's findings are summarised in the appendix.

4. A number of matters identified during the research may be taken forward in future work:

   (a) Matters being taken forward in existing projects:

      (i) IAS 19 *Employee Benefits* allows entities to report net interest on a pension liability in various ways, for example as an operating expense or as a financing expense. The

Primary Financial Statements project will consider whether this variety should be reduced.

(ii) IAS 36 *Impairment of Assets* contains a requirement to use pre-tax discount rates. The research found this to be needlessly onerous. It is being considered in the Goodwill and Impairment project.

(b) Matters that may be considered in existing or planned projects:

(i) The research pipeline includes a future project on provisions. This would involve completing research already done, with the aim of assessing whether the Board should consider amending any aspects of IAS 37 *Provisions, Contingent Liabilities and Contingent Assets*. If the Board decides to consider amending IAS 37, it could consider whether to clarify the measurement objective for provisions and whether to clarify which components should be included in the measurement of provisions.

(ii) The standards-level review of disclosures in the Disclosure Initiative could include a cross-cutting review of disclosures relating to present value measurements

(iii) For pension scheme benefits that depend on returns on plan assets, there is an inconsistency between assumptions included in the cash flows and the discount rates. The research pipeline includes a future project to assess whether it is feasible to eliminate that inconsistency, without reviewing other aspects of IAS.

5. The research identified two specific matters that the Board does not plan to address in the near future. These are as follows:

(a) Inconsistent use of OCI and profit or loss in presenting impact of present value measurements. At the moment, it seems unlikely that this will be in the scope of the Primary Financial Statements project.

(b) There is no explicit measurement objective in IAS 19 for measurement of post-employment obligations. The measurement requirements in IAS 19 are rules-based, which results in frequent requests for interpretations. Those requirements are also inconsistent with requirements for other similar liabilities. The Board has no plan to review IAS 19, except for the narrow-scope project mentioned in paragraph 4(b)(iii).

6. In addition to documenting findings from the review of IFRS Standards, the staff have prepared a list of things for staff to consider when developing requirements relating to present value measurements and the use of discount rates. This will help staff to take a more consistent approach to developing those requirements in future standard-setting.

7. The staff plan to bring back a summary of research to the Board meeting in the next month or two to discuss the following questions:

   (a) Has the research objective been met?

   (b) How can the Board and the staff make the best use of the research outputs?

   (c) Is any external consultation needed?

8. The staff are considering how best to make the work performed visible and retrievable, for example, as a research summary.

9. The staff plan to hold in the next few months a public education session for the Board on low and negative discount rates. Although this topic was beyond the scope of the research project, it has triggered public debate in the last few months.

10. The Board has no plan to carry out a comprehensive standard-setting project on discount rates.

Appendix – Summary of staff findings on the project

A1. Discount rates are one of the inputs to present value measurement techniques. Those techniques are often used to arrive at accounting measurement that cannot be observed directly. These techniques can be applied when arriving at any of the measurement bases used in IFRS Standards, such as amortised cost, fair value, value in use or fulfilment value (or a customised bases). Different discount rates (and different cash flows) may be required in order to meet different measurement objectives. For example, amortised cost measurement would use a historical/contractual discount rate and historical/contractual estimates of the cash flows (to the extent that the carrying amount is recoverable), whereas a current value measurement, such as fair value, would use current inputs. Also, current value, measurements such as value in use and fulfilment value, may use discount rates different to the ones used in determining fair value, depending on whether entity specific assumptions are included in the discount rate and on whether the entity's assumptions differ from the assumptions that market participants would make.

A2. Therefore, since IFRS Standards use a mixed-measurement model, different discount rates will justifiably be required for different measurement objectives.

A3. Also, IFRS Standards sometimes use practical shortcuts when dealing with the discount rates.

A4. However, some differences in discount rates in IFRS Standards cannot be readily explained. We have identified two types of issues:

(a) There is no explicit or clear measurement basis in some Standards that use entity-specific measurements; including IAS 19 (which does not specify a measurement basis), and IAS 37 (which refers to two different measurement bases). Without a clear measurement basis, it is not clear what that measurement should be comparable with, if anything. Also, lack of an explicit measurement basis makes it harder for entities to exercise judgement in applying the requirements of the Standard and puts pressure on the rules.

(b) It is not always clear which discount rate elements a measurement includes. This is again the case for both IAS 19 and IAS 37. There are different problems though:

(i) IAS 19 does not make it clear which elements are included in the discount rate (for example, whether the rate is meant to reflect time value of money only or also some risks). Yet the guidance is quite specific as to where to look for the rate (high-quality corporate bonds if market for them is deep, otherwise government bonds). So, in general it is relatively easy to obtain the rate but questions arise on the margins, eg what pool of data to use, what high quality is, how to match with the currency and duration of the pension liabilities and similar. Even though the rate for IAS 19 is in some cases easy to determine and verify, and therefore not costly to apply, some elements (ie credit risk of the reference portfolio of bonds used) of the rate used in the measurements are not relevant to the liability measured.

(ii) IAS 37 is vague on elements of the rate and does not prescribe where to look for the rate. This allows entities to exercise judgement when applying requirements but also leads to inconsistencies in application. Examples of inconsistences in application identified during the research include inclusion of credit risk and risk adjustment. The impact of these differences can be significant, especially for significant long-term provisions, such as decommissioning liabilities.

A5. The research also looked at present value methodology, in particular how inflation, tax and risk are reflected in the measurements. The staff found that the methodology can be overly prescriptive at times, for example requiring use of pre-tax rates in calculating value in use in IAS 36, or not clear enough, for example on the relationship between tax and discount rates. In some cases there was inconsistency between measurement inputs, such as between discount rates and cash flows for pension benefits that depend on asset returns. There were also emerging areas which are not discussed much in the IFRS Standards, such as the use of yield curves and extrapolation.

A6. Finally, the research reviewed presentation and disclosures for present value measurements. There were notable differences between use of OCI and profit or loss when presenting changes in present value measurements as well as some differences in where unwinding of discount is presented. Some IFRS Standards did not have an explicit disclosure objective.

A7. The staff do not think that many of the perceived shortfalls and inconsistencies are intentional; instead, 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.

A8. The detailed project findings are presented in paper 17B discussed at the January 2016 Board meeting[1].

A9. Feedback from GPF and other IFRS Advisory Groups and stakeholders is in agenda paper 17C, which was discussed at the same meeting.[2]

[1] http://www.ifrs.org/Meetings/MeetingDocs/IASB/2016/January/AP17B-Discount-rates.pdf

[2] http://www.ifrs.org/Meetings/MeetingDocs/IASB/2016/January/AP17C-Discount-rates.pdf