EFRAG
European Financial Reporting Advisory Group

9 October 2009

International Accounting Standards Board
30 Cannon Street
London EC4M 6XH
United Kingdom

Dear Madam/Sir

IASB Exposure Draft of proposed amendments to IAS 19 *Discount Rate for Employee Benefits*

On behalf of the European Financial Reporting Advisory Group (EFRAG) I am writing to comment on Exposure Draft 2009/10 of proposed amendments to IAS 19 *Discount Rate for Employee Benefits* (the ED). This letter is submitted in EFRAG's capacity of contributing to IASB's due process and does not necessarily indicate the conclusions that would be reached in its capacity of advising the European Commission on endorsement of the definitive interpretations/amendments on the issues.

The IASB believes an urgent amendment is needed to IAS 19 *Employee Benefits* because the increase in yield spread for high quality corporate bonds and government bonds as a result of the recent financial crisis means that an entity in a jurisdiction that does not have a deep market in high quality corporate bonds might report a significantly higher defined benefit obligation than it would in a jurisdiction that does have a deep market in such bonds, even when the underlying obligations are very similar. This is affecting the comparability of the information provided about pensions over time and between entities. It is therefore proposing an amendment to IAS 19 that would ensure that all entities would be required to use the yield on high quality corporate bonds in all cases to determine the discount rate for all employee benefit obligations.

Our detailed comments are set out in the attached appendix but, to summarise:

- Since this ED is not intended to be a comprehensive reconsideration of the accounting for employee benefits or a reconsideration of determining the discount rate for employee benefit obligations, we support the proposal in the ED to eliminate the requirement to use the government bond rate when there is no deep market in high-quality corporate bonds.

- We agree that this amendment is urgently needed.

- We have concerns about the applicability of the IAS 39 *Financial Instruments: Recognition and Measurement* guidance it is proposed IAS 19 should refer entities to when they are estimating the yield on high quality corporate bonds. In our view, entities need guidance that helps them to estimate market yields rather than individual bond yields and in particular should address issues entities may need to resolve if there is not a deep market for high quality corporate bonds in their jurisdiction. However, if developing this guidance would delay the finalisation of the amendment, we suggest that the standard is finalised without the guidance and a post-implementation review is carried out to determine whether additional guidance is needed.

- We agree that the amendment should be treated as a change in accounting policy and should be applied prospectively.

- We think the IASB should require disclosure of the assumptions made in estimating the discount rate used.

- In the longer-term, we think the issue of which discount rate to use in which circumstances is a fundamental, cross-cutting issue that the IASB should address in a separate project, so that the issue can be addressed comprehensively.

If you would like further clarification of the points raised in this letter, please contact Jeff Waldier or me.

Yours sincerely

Stig Enevoldsen
EFRAG, Chairman

Appendix
EFRAG's response to the ED's invitation to comment

Question 1 – Discount rate for employee benefits: Do you agree that the Board should eliminate the requirement to use government bond rates to determine the discount rate for employee benefit obligations when there is no deep market in high quality corporate bonds? Why or why not? If not, what do you suggest instead, and why?

Summary of EFRAG's view:

- EFRAG supports the proposal to eliminate the requirement to use the government bond rate when there is no deep market in high-quality corporate bonds, and instead require yields on high quality corporate bonds to be used in all cases to determine the discount rate for employee benefit obligations.
- In the longer-term, we think the issue of which discount rate to use in which circumstances is a fundamental, cross-cutting issue that the IASB should address in a separate project, so that the issue can be addressed comprehensively.

1 We understand the recent increased rate spread between high quality corporate bonds and government bonds has meant that the government bond rate is in some jurisdictions no longer a good proxy for the high-quality corporate bond rate. Furthermore, the increased spread has impacted jurisdictions differently, thus reducing the comparability of similar entities operating in different jurisdictions. Bearing this in mind, we agree with the IASB's decision to re-examine the existing requirement that entities should use the government bond rate when there is no deep market in high-quality corporate bonds.

2 The IASB has taken the view that this issue is urgent and that revised requirements need to be in place for the year-end 2009 adoptions. Although it is not possible to be sure what the actual spread will be at year-end, we note that the spreads are narrowing and could have returned to what some may view as normal by the time this proposal becomes effective. It is always important that the IASB strikes the correct balance between piecemeal quick fix solutions and the development of more comprehensive solutions, especially when the need for a quick fix solution might be temporary. However, we believe the IASB has done that in this case.

3 We note that some argue that, for entities that do have deep markets for high quality corporate bonds, the recent increase in the discount rate used for employee benefits has caused the obligation to be understated. Those commentators argue that it would be preferable to use a risk free rate to discount the obligation (rather than a rate, such as the high-quality corporate bond rate, that includes risk premium). However, we also recognise that the purpose of this ED is to fix a problem that has arisen, not to re-debate IAS 19's conclusions as to the type of discount rate to be used for employee benefit obligations. For that reason we will not discuss further in this letter the risk free versus high-quality corporate bond rate issue. However, the issue of which discount rate to use in which circumstances is both a cross-cutting issue and a fundamental accounting issue, and we think there is a need for a separate project on the subject, so that it can be addressed comprehensively.

4 EFRAG acknowledges that the general principle of IAS 19 was that a high quality corporate bond rate should be used to determine the discount rate, and that the requirement that the government bond rate should used in certain circumstances

was not intended to change that principle. EFRAG therefore supports the proposal to eliminate the references to the government bond rate and to require yields on high quality corporate bond to be used in all cases to determine the discount rate for all employee benefit obligations.

Question 2 – Guidance on determining the discount rate for employee benefits: For guidance on determining the discount rate, do you agree that an entity should refer to the guidance in IAS 39 *Financial Instruments: Recognition and Measurement* for determining fair value? Why or why not? If not, what do you suggest instead, and why?

Summary of EFRAG's view

- EFRAG does not support the proposal that IAS 19 should refer to the guidance in IAS 39 on the estimation of fair value to provide guidance on determining the discount rate.
- We think the guidance needed should relate to estimating a market yield and in particular should address issues entities may need to resolve if there is not a deep market for high quality corporate bonds in their jurisdiction. Perhaps this could best be done by stating the objective clearly and then suggesting ways in which that objective could be met.
- We think that developing this guidance would not delay the finalisation of an amendment that is urgently needed. However, if it might, we would encourage the IASB to finalise the standard without the guidance and then carry out a post-implementation review to determine whether additional guidance is needed.
- We think the IASB should require disclosure of the assumptions made in estimating the discount rate used.

5 Although we support the proposal to have a single principle to determine the discount rate used for employee benefit obligations and we agree with paragraph BC6 that estimating the yield on a high quality corporate bond is essentially the same task as estimating the fair value of the bond, we nevertheless do not think a reference to the fair value guidance currently in IAS 39 (or in due course to the IFRS on fair value measurements) is particularly helpful.

6 Our understanding is that IAS 19 requires use of a market yield of high quality corporate bonds, not an individual bond yield. We do not think that the IASB's intention is for entities to use an individual bond yield as representative of a market yield for the purpose of determining the discount rate of the employee benefit obligation. Yet the guidance in IAS 39 to which it is proposed IAS 19 should refer is guidance on estimating an individual bond yield. We think the guidance needed relates to estimating a market yield and, in particular, should address issues entities may need to resolve if there is not a deep market for high quality corporate bonds in their jurisdiction. Under those circumstances other issues need to be considered, including:

(a) determining whether other markets outside the jurisdiction should be considered,

(b) identifying specific bonds in those market to use in determining the yield, and

(c) whether some bonds should be given greater weight than others to arrive at a yield that reflects a market of high quality corporate bonds.

7 We note also that the IAS 39 guidance which it is proposed IAS 19 should refer to includes paragraphs on active markets and on valuing equity instruments. We do not think it is helpful to refer those trying to estimate high-quality corporate bond rates to such material.

8 Our suggestion is that, rather than IAS 19 refer specifically to IAS 39's guidance, it should set the objective clearly and then suggest ways in which that objective could be met. For example, we think it would be helpful if IAS 19 suggested that a pragmatic approach when there is no deep market for high quality corporate bonds in the local jurisdiction (ie when a level one-type input cannot be used) could be to use level two-type inputs such as the rate spread between high quality corporate bonds and government bonds in a jurisdiction where there is a deep market and then apply that rate spread to the local government bond rate to approximate a local yield on high quality corporate bonds.

9 We think this guidance can be developed quickly and would therefore not delay the finalisation of an amendment that is urgently needed. However, if the IASB thinks that will not be the case, we would encourage the IASB to finalise the standard without the guidance and then carry out a review of the amendment's implementation for 2009 year-ends to determine whether there is a need for additional guidance.

10 We think users would find it useful if entities disclosed the assumptions they have made in estimating the discount rate used, so we suggest that the IASB should require such disclosures.

Question 3 – Transition: The Board considered whether the change in the defined benefit liability (or asset) that arises from application of the proposed amendments should be recognised in retained earnings or as an actuarial gain or loss in the period of initial application (see paragraph BC10) Do you agree that an entity should:

(a) apply the proposed amendments prospectively from the beginning of the period in which it first applies the amendment?

(b) recognise gains or losses arising on the change in accounting policy directly in retained earnings?

Why or why not? If not, what do you suggest instead, and why?

Summary of EFRAG's view

- We agree with the ED's proposal that the change in discount rate that this amendment will sometimes cause should be treated as a change in accounting policy.
- EFRAG agrees that the amendment should be made prospectively.

11 IAS 8 *Accounting Policies, Changes in Accounting Estimates and Errors* explains what IFRS means when it refers to 'accounting policies' (and therefore 'a change in accounting policy') and 'a change in accounting estimate'.

(a) 'Accounting policies' are the specific principles, bases, conventions, rules and practices applied by an entity in preparing and presenting financial statements.

(b) 'A change in accounting estimate' is an adjustment of the carrying amount of an asset or a liability, or the amount of the periodic consumption of an asset, that results from the assessment of the present status of, and expected future benefits and obligations associated with, assets and liabilities. Changes in accounting estimates result from new information or new developments and, accordingly, are not corrections of errors.

12 A change in the amount of a liability that results from a change in the discount rate caused by this amendment does not meet the definition of 'a change in accounting estimate', but does meet the description of an accounting policy. For that reason, EFRAG agrees with the proposal in the ED that the amendment should be treated as a change in accounting policy.

13 We also agree with the ED that the proposed amendment should be applied on a prospective basis, for the reasons set out in the ED's Basis for Conclusions.