# IASB proposes move to corporate bond based discount rates for all markets



On 20 August, the International Accounting Standards Board (IASB) issued an exposure draft covering changes proposed at their July meeting. The proposals cover, amongst other items, what discount rates should be used to measure IAS19 pension liabilities in countries where there is no 'deep' corporate bond market. Following their review, the IASB concluded that companies should use discount rates based on yields of high quality corporate bonds (or a suitable proxy) to measure pension liabilities in all countries.

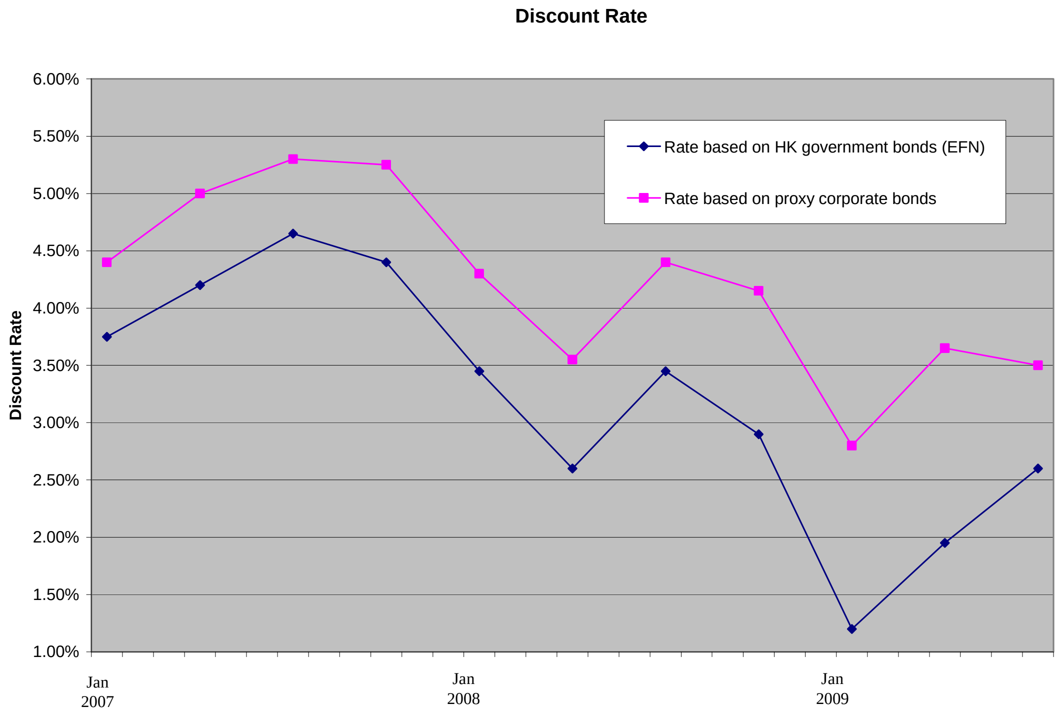
### Inconsistency in current practice not desirable

Currently IAS19 reporting in respect of countries such as Hong Kong with no deep corporate bond market requires the use of a discount rate based on government bond yields, whereas countries with a deep corporate bond market will use corporate bond rates. This inconsistency in accounting treatment is an issue that Watson Wyatt and other practitioners have been pursuing with the IASB for some time. The issue has become more pronounced recently as a result of market turmoil. We were pleased that the issue has been acknowledged by the IASB and a proposal has been made.

### Pension liabilities for Hong Kong companies could be lower

For companies in Hong Kong currently using yields on government bonds (or Exchange Fund Notes) to set the discount rate, the proposed change will lead to a higher discount rate, by about 1-2%, and lower pension liabilities, possibly by 10-20%. Further, the change may lead to a lower pension expense charge to the profit and loss account.

The chart below shows discount rates derived using yields on Hong Kong government bonds (i.e. the current approach) and those based on US corporate bonds (a potential ‘proxy’ approach), both with a duration of 10 years.

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The change will impact companies in different ways, and the extent to which a company's liabilities and pension charge might change will vary. Companies may wish to consider the likely impact under various scenarios.

## Guidance on setting discount rate is still not clear

It should be noted that no specific guidance is provided in the Exposure Draft on the definition of "high quality corporate bonds", or the methodology to be used to determine the yields on high quality corporate bonds. In some markets, the change will introduce a degree of professional judgment to determine a reliable and consistent measure of a high quality corporate bond yield - particularly in markets where such bonds are in short supply (or do not even exist). However, the IASB felt that global consistency (to overcome the issues mentioned earlier) outweighed the increased need to exercise judgment in determining proxy corporate bond yields in such markets.

## Timing and transition

The IASB intends to implement the proposed changes at the same time as other changes which are due to be introduced in 2013. However, the IASB recognises the urgency of this issue, and earlier adoption of the new methodology for financial years ending on or after 31 December 2009 is encouraged.

It is proposed that the change in the discount rate approach should be applied prospectively at the beginning of the period in which the change is effective, with a resulting one-off adjustment being recognised immediately via retained earnings.

We would expect that changes to IAS19 will also be adopted in a timely manner by the Hong Kong Institute of Certified Public Accountants in HKAS 19.

## Comments on the Exposure Draft

Comments on the Exposure Draft must be submitted by 30 September 2009. In addition to the general question of whether the requirement to use government bonds in "non deep" markets should be removed, the IASB has specifically asked for comments on discount rate setting and applying the change retrospectively.

Watson Wyatt will be reviewing these proposals closely and will be providing comments to the IASB.

For information, the Exposure Draft can be found at: http://eifrs.iasb.org/eifrs/files/47/edproposedamendmentsias19discountrates_198.pdf

## Further Discussion

If you have any questions, please contact your usual Watson Wyatt consultant, or

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