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Technical Accounting Alert

Change in discount rates used for measuring employee benefits

Introduction

Under AASB 119 *Employee Benefits*, the discount rate used in measuring defined benefit obligations and other long term employee benefits (such as long service leave, annual leave classified as long-term, profit sharing and bonus plans) is required to be determined by reference to market yields on 'high quality' corporate bonds. Where there is no 'deep market' for such bonds, the Standard requires entities to use market yields on government bonds. As a result of this requirement in AASB 119, entities in Australia have to date been using government bond rates when measuring defined benefit obligations and other long-term employee benefits.

Over the last few years, there has been considerable discussion in the accounting and finance professions as to whether there was a sufficiently observable, deep and liquid market in high quality corporate bonds in Australia that would satisfy the requirements in AASB 119. As a result, in September 2014, the Group of 100 commissioned Milliman Australia ('Milliman') to undertake research in relation to the corporate bond market in Australia. The objective of this research was to determine whether there was a sufficiently observable, deep and liquid market in high quality corporate bonds in Australia that would meet the requirements of AASB 119. To the extent that there was sufficient support for a deep and liquid market, the goal was then to determine a methodology to derive a full discount rate curve, allowing for possible limitations in available corporate bond market data, to enable the development of a standardised set of discount rates which would be made publicly available as a transparent central reference point for all entities to use on an ongoing basis.

All major accounting firms in Australia, including Grant Thornton, provided input to this research throughout the research and methodology development process.

Outcome of the research and its accounting implications

In April 2015, Milliman released its final report entitled "*Discount Rates for Australian Employee Benefit Liability Valuation*" which concluded that there is a sufficiently observable, deep and liquid market in high quality Australian corporate bonds to satisfy the requirements in AASB 119.

This means that all entities, other than not-for-profit public sector entities, are now required to use corporate bond rates (instead of government bond rates) when measuring defined benefit obligations and other long-term employee benefits. It will no longer be acceptable for such entities to continue using government bond rates for the purposes of complying with AASB 119. Nevertheless, entities in the not-for-profit public sector will continue to use government bond rates as specifically required in paragraph Aus83.1 of AASB 119.

Milliman will calculate and publish a blended high quality corporate bond rate incorporating bonds rated AAA or AA by credit rating agencies (namely, S&P, Fitch and Moodys). The first set of discount rates will be made available in June 2015 based on 31 May 2015 data, for use in the preparation of accounts for the year ended 30 June 2015, with rates to then be produced quarterly thereafter. Published discount rates will be available on both the G100 website (www.group100.com.au) and Milliman Australia's website (http://au.milliman.com).

Effective date and transition

Based on the analysis in the Milliman report, there is now a deep market for high quality corporate bonds in Australia. Therefore, discount rates will need to be determined by reference to high quality corporate bond rates for all annual and interim reporting periods ending on or after 30 June 2015.

As per AASB 119.128, the change in discount rate will result in actuarial gains and losses, and the accounting for these actuarial gains and losses will vary depending on whether the liability is a defined benefit obligation or other long-term employee benefits. The actuarial gains and losses relating to defined benefit liability are recognised in other comprehensive income (AASB 119.120(c)), whereas the actuarial gains and losses relating to other long-term employee benefits are recognised in profit or loss (AASB 119.156(c)).

The change to high quality corporate bond rates is considered to be a change in accounting estimate in accordance with AASB 108 *Accounting Policies, Changes in Accounting Estimates and Errors* and therefore will be accounted for prospectively. This means that the actuarial gains and losses arising from this change will be recognised in the period in which the change takes place and will not affect prior periods. As this is a change in accounting estimate, the relevant disclosure requirements in AASB 108 (in particular, AASB 108.39-40) will also need to be complied with upon transitioning to high quality corporate bond rates.

Grant Thornton Comment

Grant Thornton accepts the analysis in the Milliman report and the conclusion that there is sufficiently observable, deep and liquid market in high quality corporate bonds in Australia. Grant Thornton also considers that the rates published by Milliman will be an acceptable source for determining the discount rate for measuring defined benefit obligations and other long-term employee benefits under AASB 119.

Considering that corporate bond rates are greater than Australian government bond rates, we expect the carrying amounts of employee benefit liabilities to be lower as a result of this change. The largest impact is likely to be on those companies with large number of employees and those with defined benefit plans.

Further information

For further details on any of the information included in this Technical Accounting Alert, please get in touch with your local Grant Thornton Australia contact or a member of the National Audit Support Team at nationalaudit.support@au.gt.com.