

IAS 19: Discount Rates

Extract, IFRS Discussion Group Report on Meeting – May 14, 2015

According to IAS 19 *Employee Benefits*, the rate used to discount post-employment benefit obligations reflects the estimated timing of benefit payments. In practice, entities often apply a single weighted average discount rate that reflects the estimated timing of benefit payments when calculating the defined benefit obligation, interest cost and current service cost for a defined benefit plan. This practice is referred to as the “traditional approach.”

With improvements in computer power and modelling programs, it is possible for calculations to be undertaken on a more granular basis. Four possible alternative approaches to the traditional approach have been recently discussed in practice: a split discount rate approach; a yield-curve approach; a mixed approach; and a vector approach.

Under a split discount rate approach, the plan is separated into different categories of plan members (for example, pensioners and active members). A single weighted average discount rate is determined using the traditional approach for each category of member to calculate its respective defined benefit obligation, interest cost and current service cost, if applicable.

A yield-curve approach applies the discount rates from the yield curve that match the expected timing of benefit payments (i.e., the spot rates for each individual time band) to calculate the defined benefit obligation and current service cost.

Under a mixed approach, the current service cost is calculated using the split discount rate approach or the yield-curve approach to give consideration to the different categories of members. However, the defined benefit obligation and interest cost are calculated using the traditional approach.

The vector approach relates only to the interest rate used to calculate interest cost and would be applied in combination with any of the other three approaches. Under this approach, the interest cost is calculated by applying the one-year forward rate to the defined benefit obligation at the beginning of the period.

Issue: Which of the approaches outlined above are consistent with the discount rate requirements in IAS 19?

View A – Traditional approach only.

This view considers paragraph 85 of IAS 19 to require a single weighted average discount rate. Measurements under IAS 19 are expected to be inherently imprecise, thus changing the discount rate adds undue complexity.

View B – Traditional approach and split discount rate approach.

This view considers both approaches to be acceptable under IAS 19. The split discount rate approach is considered to be a refinement to the requirements in IAS 19 because it provides more accurate and better information. It gives consideration to the fact that payments to active employees tend to be further in the future than payments to pensioners. Thus, separating the plan calculations into different

categories of participants would yield more accurate estimates of the current service cost and would be a refinement in the calculation of pension expense.

View C – Traditional approach, split discount rate approach and yield-curve approach.

This view considers the yield-curve approach to be another acceptable method. If benefits are uniformly attributed across the expected service lifetime of employees (which is generally the case under the projected unit credit method), the yield-curve approach would result in the same outcome as the split discount rate approach calculated on a granular basis. However, if benefits are not uniformly attributed across the expected service lifetime of employees, the outcome of the yield-curve approach may be different than performing separate calculations for each individual. If the yield-curve approach is applied, when the stratified sections of the plan's population are aggregated for disclosure purposes, it appears as though different discount rates have been applied to calculate the defined benefit obligation and current service cost for the entire plan.

View D – Traditional approach, split discount rate approach, yield-curve approach and mixed approach.

This view considers a mixed approach such as calculating the current service cost using the split discount rate approach but calculating the defined benefit obligation and interest cost using the traditional approach. Under this view, a mixed approach may result in more accurate information.

The Group's Discussion

Group members observed that the terminology used by the actuarial community may be different than that used for the approaches described above. The focus of the discussion was to first determine whether an approach other than applying a single weighted average discount rate is permissible under IAS 19. If Group members thought an alternative approach is permitted under IAS 19, the question of whether a resulting change would be considered a change in accounting policy or change in estimate may be discussed by the Group at a future meeting. The defined benefit obligation would be the same under all the approaches described above, but there could be a difference in the amount recognized in profit or loss and other comprehensive income or loss.

Group members noted that IAS 19 does not appear to preclude the use of alternative approaches. They tended to support the use of the split discount rate approach because for each category of plan member, the same discount rate is used to calculate the three components (i.e., defined benefit obligation, current service cost and interest cost). However, one Group member noted that there could be practical challenges in terms of how to apply the split discount rate model to a funded plan's assets for the purposes of the net interest calculation. These challenges arise because the investments are not split by category of plan member and, thus, it would be difficult to segregate the plan assets into different groups. A concern with the yield-curve or mixed approach was that a different discount rate is being used to calculate the three components. Group members noted that the vector approach was not permissible based on the wording of IAS 19. Overall, Group members emphasized it is important to look at the underlying details of any model given the potential terminology differences to understand if the calculations are aligned with the requirements in IAS 19 and if the model is being applied consistently from period to period. If a different discount rate approach is used, it is also important to understand the effects it will have on the components of defined benefit cost.

Group members observed that this issue is not unique to Canada and that different practices are emerging in the United States and Europe. There are ongoing discussions at the U.S. Securities and Exchange Commission about the use of alternative approaches in calculating a discount rate and what the related implications are. The IASB also has a research project related to accounting for all post-employment benefits plans including new pension plan design. In addition, the Public Sector Accounting Board sees pensions as an important topic and their work may have an effect on the private sector.

Given the various channels of work on pensions, the Group recommended not raising this issue to the IASB or the IFRS Interpretations Committee at this time but monitoring the issue for future developments.

(For a full understanding of the discussions and views expressed, listen to the [audio clip](#)).