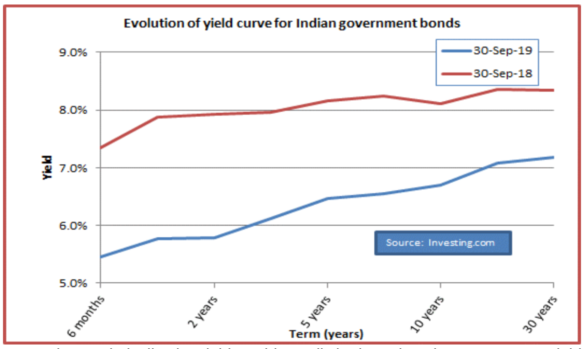
The evolution of the discount rates for measuring employee benefit obligations under Indian and International Accounting Standards – 30 September 2019

October 2019

This briefing note analyses the evolution of the discount rate for measuring employee benefit obligations under AS15(R), AS19 and IAS19. We consider the change in discount rates and the impact on the change in the value of your obligations over the last 12 months.

The discount rate for accounting purposes is set with reference to the yield on Indian government bonds. We use this rate to calculate the current cost of providing the benefits we expect you to pay in the future. The particular rate taken is assessed based on the yield curve at the date of your valuation and the average duration of your liabilities.

The chart below indicates how the yield curve has changed during 2018/19:



* Note that, technically, the yield would usually be based on the zero-coupon yields for the relevant duration; the coupon yielding bonds are shown here for illustration purposes

As evident from the chart, implied yields have fallen remarkably over the last 12 months. The reductions have varied by the maturity dates of the bonds.

The impact of these various reductions will depend the duration of your liabilities. The duration represents the expected term of remaining employment of the participants of your benefit plan, taking into account the assumptions made for resignation, retirement, disability and mortality. The impact will also depend on the rounding methodology you employ in setting the discount rate. However, generally speaking, a lower yield will lead to a higher disclosed liability.

For instance, if your practice is to take a discount rate rounded to the nearest 0.1%:

· for a liability duration of five years, the implied discount rate has fallen approximately 1.7% since 30 September 2018; in isolation this may suggest an increase in defined benefit obligations of approximately 8%

· for a liability duration of 10 years, the implied discount rate has also fallen approximately 1.4% since 30 September 2018; in isolation this may suggest an increase in defined benefit obligations of approximately 14%

· for a liability duration of 15 years, the implied discount rate has fallen approximately 1.3% since 30 September 2018; in isolation this may suggest an increase in defined benefit obligations of approximately 20%.

Other news

We are seeing greater scrutiny of the other assumptions being used in assessing the liabilities and annual expense. In particular, lower discount rates will mean the assumption for turnover (resignations or early terminations) will have a more meaningful impact on the results. This assumption should be determined specifically for the client – a broadly established assumption will potentially produce misleading results. It will be critical that clients understand the impact of this assumption on their disclosures.

We would be happy to talk with you in greater detail about the discount rate applicable to your plan, or indeed any other employee benefit issue.

CONTACT

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