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Ready for year end accounting?

Discount rate update – Feb'20

Mar, 2020

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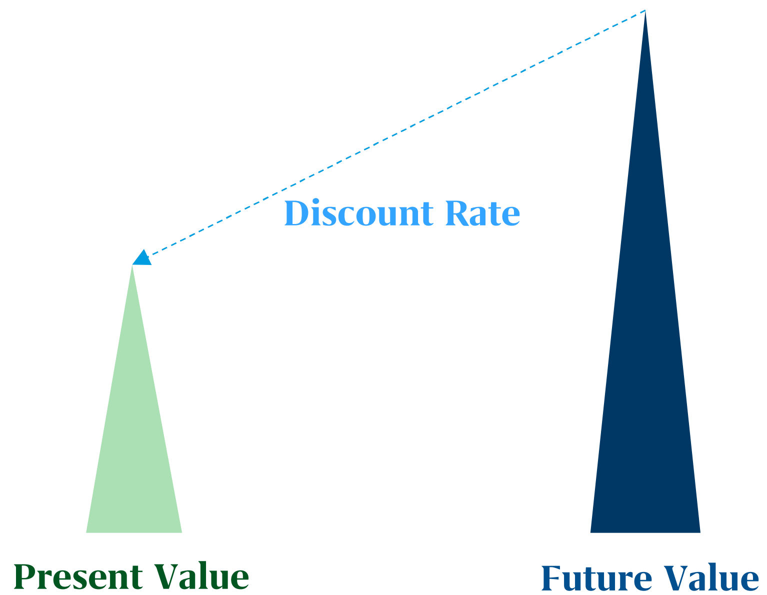
Background

All DB schemes have some form of employer commitment to give benefit in future for employee service rendered now. These future payments materialize on certain event in employee lifetime like termination, retirement, vesting etc.

Various accounting standards like IFRS, INDAS19, AS15R etc. require company's to report obligation (or liability) w.r.t these commitments.

Estimation of these benefits thus involve future projection & study of events likely to occur in employee lifetime & corresponding payments by employer. To derive current value of these future payments, discount rate is used.



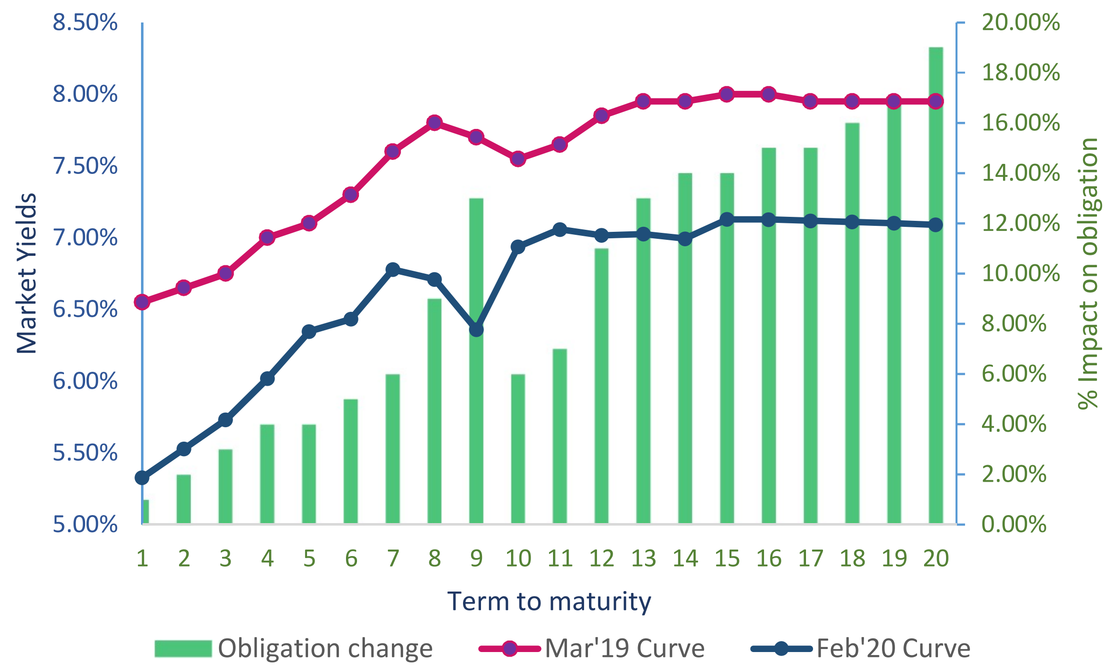
The discount rate is the rate of return used to discount future cash flows in order to arrive at their present value.

Latest updates

Accounting standards & Guidance note APS27 issued by Institute of Actuaries of India recommends discount rate to be referenced based on latest yields of Government of India bonds.

On a standalone basis, fall in discount rates will lead to increase in scheme liability. Also this impact will increase as tenure of payments in future increase.

Hence schemes where employees are expected to stay longer or pension schemes where payments happen well beyond retirement, will see greater impact on liability due to fall in discount rates.



Since Mar’19, yields of GOI bonds have fallen for almost all duration by about 1%. This change may increase scheme obligation in range of 5-15%.

Bond yields source: Financial Benchmarks India Private Limited

Future outlook

Outbreak of coronavirus has triggered not only health panic but have also brought many central banks in action. US Federal has recently done a benchmark rate cut of 50 bps. G-7 finance ministers also pledge to take more coordinated actions.

Virus outbreak, slowdown in Indian economy, accommodative stance of RBI, seems to give ample indications to bond market of likely rate cuts. This seems to drive bond market rally & cause for bond yields falling.

Hence we expect it is less likely for bond yields to recover significantly in remaining month of Mar'20 before fiscal year end.

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Getting ready

With fiscal year end nearby, companies can look to get a preliminary actuarial valuation done for their DB schemes. This may utilize a Feb'20 end data and will help company assess estimated impact on financials.

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Work with your Actuary to assess reasonableness of all other assumptions. Many times it is the correlation effect of assumptions that make more significant impact on scheme liability than standalone assumption.

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