

Determining the present value of a provision

When determining the present value of a provision, the discount rate, inflation rate and wage growth rate are to be based on specified factors. This Circular withdraws and replaces NSWTC 06/16 *Rates/Indices for Measuring Provisions at Present Value*.

A 'provision' is defined as a liability of uncertain timing or amount. Where settlement is expected to be deferred for some time, various standards require the liability to be measured at present value. For example, AASB 119 *Employee Benefits*, AASB 137 *Provisions, Contingent Liabilities and Contingent Assets* and AASB 1023 *General Insurance Contracts* require certain provisions for superannuation, long-service leave, workers' compensation, insurance claims, etc, to be measured at present value.

The present value of an existing obligation, such as a provision, is the amount payable in the future, discounted at a selected rate. In some cases, the amount payable in the future may also be affected by changes in wages and salaries or in general prices in the intervening period.

When determining present value it is necessary to make economic assumptions about the discount rate and possibly also the inflation and wage growth rates. Such assumptions are based on market expectations, at the end of the reporting period, for the period over which the provision is to be settled.

For consistency and comparability within the NSW public sector and the Total State Sector Accounts, agencies should use the following specified factors as the bases for the economic assumptions applied to determine present value of a provision. The factors may need to be extrapolated, interpolated or modified if necessary to reflect entity-specific risks or circumstances.

- The **discount rate** is to be based on the market yield on Commonwealth government bonds as published by the Reserve Bank of Australia. See Indicative Mid Rates of Commonwealth Government Securities (Table F16) at www.rba.gov.au/statistics/tables/#interest_rates.
- The **inflation rate** is to be based on the projected Sydney consumer price index as set out in the Medium Term Outlook in the most recent NSW *Budget Statement* (Budget Paper No 2)¹ at www.budget.nsw.gov.au.
- The **wage increase rate** is to be based on the projected wage price index as set out in the Medium Term Outlook in the most recent NSW *Budget Statement* (Budget Paper No 2)¹ at www.budget.nsw.gov.au.

This Circular withdraws and replaces NSWTC 06/16 *Rates/Indices for Measuring Provisions at Present Value* without substantively changing its content.

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1. In Budget Paper No 2 for 2011-12, the price indices appeared in Chapter 2, page 2-18.