IFRS Accounting

# Staff paper

Agenda reference: 22A (Appendices)

**IASB® meeting**

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| Date | **July 2023** |
| Project | **Provisions—Targeted Improvements** |
| Topic | **Discount rates—reference information** |
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This paper sets out information referred to in Agenda Paper 22 *Provisions—Targeted Improvements—Discount rates—stakeholder views*. It comprises:

| Contents | |
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| **Appendix A** | A summary of the main messages in the staff paper discussed at the October 2022 IASB meeting. |
| **Appendix B** | An extract from the summary of the Capital Markets Advisory Committee (CMAC) meeting held on 6 October 2022 |
| **Appendix C** | An extract from the summary of the Global Preparers Forum (GPF) meeting held on 11 November 2022 |
| **Appendix D** | An extract from the summary of the Accounting Standards Advisory Forum (ASAF) meeting held on 8–9 December 2022 |

This paper does not ask the IASB any questions.

# Appendix A—SUMMARY OF MAIN MESSAGES IN STAFF PAPER DISCUSSED AT OCTOBER 2022 IASB MEETING

## Agenda Paper 12A *Provisions—Targeted Improvements—Discount rates—non-performance risk*

| Chapter | Main messages |
|---|---|
| **1**<br>**Why we are discussing this topic** | In a research project on Discount Rates in IFRS Standards, the IASB identified several matters that it could consider addressing in other projects. Among those matters was the lack of clarity in IAS 37 on the inputs to include in the discount rates used to measure provisions—and, in particular, on whether to include non-performance risk. |
| **2**<br>**When the discount rate is important and why** | The effect of discounting is most likely to be material for large long-term provisions—typically, provisions for asset decommissioning and environmental rehabilitation costs recognised by entities operating in the oil & gas, mining and utility (including power generation) and telecommunications sectors.<br>Reflecting non-performance risk in a discount rate increases the rate. Entities that use higher discount rates may report over the duration of a provision:<br>• smaller liabilities and lower gearing;<br>• higher gross profit margins and correspondingly larger finance costs; and<br>• larger profits in the earlier years and smaller profits in the later years. |
| **3**<br>**Discount rate requirements** | IAS 37 requires entities to discount provisions using rates that reflect:<br>a) the time value of money; and<br>b) the risks specific to the liability, to the extent those risks are not reflected in the cash flows.<br>IFRS 13 *Fair Value Measurement* requires the measure of the fair value of a liability to capture the non-performance risk relating to that liability.<br>/ Continues |

| Chapter | Main messages |
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| | IFRS 16 *Leases* requires lessees to discount lease payments at the rate implicit in the lease if that rate can be readily determined, or at the lessee's incremental borrowing rate if not.<br><br>IFRS 17 *Insurance Contracts* requires insurers to discount insurance contract liabilities at a rate that excludes non-performance risk, on the basis that including the effects of a change in the insurer's own non-performance risk in the measure of its insurance contract liabilities would not provide useful information.<br><br>IAS 19 *Employee Benefits* requires entities to discount post-employment benefit obligations at a rate determined by reference to market yields on high quality corporate bonds (or, for currencies in which there is no deep market in such bonds, the market yields on government bonds denominated in that currency). The Basis for Conclusions argues that 'the discount rate should not reflect the entity's own credit rating, because otherwise an entity with a lower credit rating would recognise a smaller liability'.<br><br>US Generally Accepted Accounting Principles (US GAAP) for asset decommissioning and related environmental rehabilitation obligations differ from IAS 37 requirements in several ways. US GAAP requires an entity to<br>• recognise only legal (not constructive) obligations;<br>• measure those obligations at fair value on initial recognition, using a credit-adjusted risk-free rate; and<br>• subsequently update the measure for changes in estimates of cash flows but *not* for changes in discount rates. |
| **4**<br><br>**Current practice** | Findings of academic research and feedback from national standard setters indicate that:<br><br>(a) accounting practices diverge—many entities use rates that exclude non-performance risk, while many others use rates that include it;<br><br>(b) diversity exists across and within sectors and across jurisdictions; and<br><br>(c) one or other practice might predominate in some jurisdictions—for example, for legacy reasons—but neither predominates in all jurisdictions. |

| Chapter | Main messages |
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| **5**<br><br>**Factors that could affect the IASB's decision** | In assessing whether the discount rate for provisions should include non-performance risk, the IASB could consider:<br><br>(a) *the requirement in IAS 37 to include 'risks specific to the liability'*. The staff conclude that the non-performance risk associated with a liability is specific to that liability.<br><br>(b) *the intentions of the International Accounting Standards Committee (IASC)*[1] *when it developed IAS 37*. We have evidence that, in referring to the 'risks specific to the liability', the IASC was referring to the variability in the cash flows required to *settle* the liability, which would generally be reflected by either increasing the estimates of the cash flows or by *decreasing* the discount rate. We have no evidence that the IASC had in mind the risk that the entity would *fail to settle* the liability, which would be reflected by *increasing* the discount rate.<br><br>(c) *the measurement concepts in the IASB's Conceptual Framework for Financial Reporting*. The *Conceptual Framework* describes three current value measurement bases: fair value, fulfilment value and current cost. It states that those measurement bases can be modified, noting as an example that fulfilment value can be modified to exclude non-performance risk. The *Conceptual Framework* observes that 'modifying measurement bases may sometimes result in information that is more relevant to the users of financial statements or that may be less costly to produce or to understand'.<br><br>(d) *a difference between provisions and other liabilities*. Most liabilities arise from commercial exchange transactions. The cash outflows required to settle such liabilities include (either explicitly or implicitly) a premium payable to the counterparty to compensate it for accepting non-performance risk—the cash outflow for the premium is recognised as part of the interest or discounting expense. In contrast, the cash outflows required to settle a provision typically do not include a premium payable to the counter party to compensate it for accepting non-performance risk—there is no cash outflow to recognise as an expense.<br><br>/ Continues |

1 The IASB's predecessor body, which issued IAS 37.

| Chapter | Main messages |
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| | (e) *the lack of clarity in the measurement objective of IAS 37*. A tension between two paragraphs in IAS 37 means there is no clear answer on whether including or excluding non-performance risk is more consistent with the measurement objective*:*<br>(i) the 'black letter' measurement objective in paragraph 36 of IAS 37 requires a prediction of the outcome—the best estimate of the expenditure required to settle the present obligation. It can be argued that this objective implies a measure that excludes non-performance risk (except in the rare circumstances where the expenditure required to settle a provision includes a premium payable to compensate the counterparty for non-performance risk).<br>(ii) however, paragraph 37 of IAS 37 introduces a notion of a valuation—the amount the entity would rationally pay to settle the obligation at the end of the reporting period, or to transfer it to a third party at that time. It can be argued that the amount an entity would rationally pay to be relieved of an obligation would reflect the probability of non-settlement. This probability could be reflected adjusting the discount rate for non-performance risk.<br>*(f) information provided to investors:*<br>(i) if provisions are discounted at a rate that *excludes* non-performance risk:<br>• the measure of the provision tells investors the amount the entity would need to invest in risk-free assets to fund the settlement of the obligation when due; and<br>• the absence of a non-performance risk adjustment in in the discount rate tells investors that the entity incurs no expense for non-performance risk—it is not required to compensate the counterparty for accepting that risk.<br>(ii) if provisions are discounted at a rate that *includes* non-performance risk:<br>/ Continues |

| Chapter | Main messages |
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| | • the measure of the provision places an economic value on the entity's obligation (and the counterparty's claim) making the provision more comparable with other liabilities measured at a current value. It tells investors that the liability is less onerous than an otherwise-identical liability that does require the entity to pay a non-performance risk premium.<br><br>• the discount rate tells investors about the level of non-performance risk in the liability. This risk exists and transfers to the counterparty irrespective of whether the entity compensates the counterparty for accepting the risk.<br><br>(g) *'counter-intuitive' outcomes*. If the discount rate for a liability reflects non-performance risk, an increase in that risk can result in the reduction in the measure of the liability and recognition of a gain. People often describe that outcome as counter-intuitive and argue that recognising a gain from a deterioration in an entity's financial position is potentially mis-leading if (as is the case with a provision) the entity cannot realise that gain.<br><br>However, these arguments might carry less weight for provisions than for other liabilities. Information about the effects of discounting is most likely to be material for asset decommissioning and environmental rehabilitation provisions. For those types of provisions, the effects of increases in discount rates typically are not recognised as gains in the period of change—typically, they are deducted from the cost of the related property, plant or equipment.<br><br>(h) *measurement uncertainty*. There might be little evidence available to quantify the non-performance risk associated with a provision within the scope of IAS 37. Consequently, any estimate of a non-performance risk adjustment would be subjective, leading to loss of comparability. In some cases, the level of measurement uncertainty could be so high that it may be questionable whether any estimate would provide a sufficiently reliable measure of the risk.<br><br>/ Continues |

| Chapter | Main messages |
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| | (i) *convergence with US GAAP*. Requiring an entity to discount an asset decommissioning or environmental rehabilitation obligation at a credit-adjusted rate would eliminate a difference between US GAAP and IAS 37 requirements for those obligations. However, it would eliminate only one of several differences. Eliminating only one difference might be of little value to preparers and users of financial statements. |
| **6**<br>**Related matters** | *Liquidity characteristics*<br>The counterparty to a provision typically cannot sell its rights in a market. So, in theory, that counterparty would require a higher return from those rights than it would require from a liquid bond. The conclusions the IASB reaches on non-performance risk could affect any conclusions it reaches on illiquidity. The IASB could return to this matter once it has reached tentative decisions on non-performance risk.<br>*Disclosure*<br>Unlike other IFRS Accounting Standards that require the use of present value techniques, IAS 37 has no specific requirement for entities to disclose either the discount rates they have used or the basis on which those rates have been determined. Stakeholders often tell us that in adequate disclosure of that information exacerbates the problems created by diversity in the bases on which rates are determined. The IASB could return to this matter once it has reached tentative decisions on non-performance risk. |

## Appendix B—EXTRACT FROM Meeting Summary—Capital Markets Advisory Committee meeting 6 October 2022

## IAS 37 *Provisions, Contingent Liabilities and Contingent Assets*

B1. This session sought CMAC members' views on the discount rates companies use to measure liabilities within the scope of IAS 37 *Provisions, Contingent Liabilities and Contingent Assets*, with a focus on provisions for asset decommissioning and environmental rehabilitation costs.

### *Rates used*

B2. The staff explained that entities use a variety of bases for determining discount rates. Some entities use market-based risk-free rates; other entities use higher 'credit-adjusted' rates, which reflect the entity's own credit risk.

B3. Members were asked for their views on:

(a) whether information about the provisions would be more useful if all entities used the same basis to determine the discount rates for their provisions; and, if so

(b) whether IAS 37 should require entities to use risk-free rates or credit-adjusted rates.

B4. Some members said they would prefer a requirement to use credit-adjusted rates. The reasons they gave were that:

(a) conceptually, from the perspective of an equity investor, any economic measure of a liability reflects the possibility that the entity might go bankrupt and, if it does, would avoid having to settle the liability. The counterparty—which might be a government in the case of decommissioning and environmental liabilities—might have to pick up the costs and therefore share the burden of the liability.

(b) provisions calculated using credit-adjusted discount rates are more comparable with other liabilities, because these other liabilities typically reflect credit-adjusted rates.

(c) provisions measured applying IAS 37 with credit-adjusted discount rates would be comparable with those measured applying US GAAP (which require provisions to be measured using a credit-adjusted rate).

B5. Other members said they would prefer a requirement to use risk-free rates. They said:

(a) the economic value of the liability is not useful information for them:

(i) an equity analyst said that in valuing an entity, she subtracts the cost of liabilities.

(ii) credit analysts said information about the amount and timing of the cash flows required to settle the obligation is more useful than knowing its economic value. Reducing measures of liabilities by an estimate of the credit risk in those liabilities is not helpful because analysts are trying to assess this risk themselves. Furthermore, even in bankruptcy, administrators would be seeking a settlement larger than the credit-adjusted amount.

(b) credit adjustments are highly subjective.

B6. Members noted that equity analysts supported credit-adjusted rates more than credit analysts did. Members suggested ways in which financial statements could satisfy the needs of both groups and overcome concerns about the subjectivity of credit adjustments. Suggestions included:

(a) requiring entities to measure provisions using a credit-adjusted rate, but also to disaggregate (or gross up) the measure to disclose its inputs, which include:

(i) the undiscounted cash flows;

(ii) the effect of the time value of money (based on a risk-free rate of interest); and

(iii) the effect of the credit risk adjustment;

(b) requiring companies that use a rate higher than a risk-free rate:

(i) to disclose the reason(s) for adjusting the risk-free rate and the size of the credit adjustment; and

(ii) to provide a sensitivity analysis, for example identifying the effect a one percentage point change in the discount rate would have on the measure of the provision.

### *Disclosure of information about discount rates used*

B7. CMAC members were asked for their views on:

(a) whether entities with long-term provisions disclose enough information about the discount rates they used to measure these provisions; and, if not,

(b) what further information would be useful.

B8. Members suggested that:

(a) the basic information should include the discount rates used, and a description of the basis used to determine the rates.

(b) additional information is needed if the rates used are not risk-free rates, that is, if the rates are adjusted for other factors, such as credit risk. This information might include:

(i) the reasons for adjusting risk-free rates, the logic followed in calculating the adjustments, and the effect of the adjustments; and

(ii) a sensitivity analysis, to allow analysts to adjust the amount of the provision if they want to use rates other than those used by the company.

(c) the undiscounted amount and timing of the cash flows (the cash flow profile) assumed in estimating the provision would be particularly useful.

(d) the date on which it is assumed the decommissioning or rehabilitation activities will start should be included. At this time there will be a sudden switch from net inflows to net outflows.

(e) a discussion of the uncertainties affecting the assumptions is also needed.

B9. A member noted that some companies already disclose the types of information that members suggested would be useful.

## Appendix C—EXTRACT FROM Meeting Summary—Global Preparers Forum meeting 11 November 2022

## IAS 37 *Provisions, Contingent Liabilities and Contingent Assets*

C1. This session sought GPF members' views on the discount rates entities use to measure provisions within the scope of IAS 37 *Provisions, Contingent Liabilities and Contingent Assets*. The discussion focused on long-term asset decommissioning and environmental rehabilitation provisions.

### *Discount rates used*

C2. The staff explained that entities use various discount rates to determine the present value of a provision that will be settled in the future. Some entities use market-based risk-free rates; other entities use higher rates that reflect the risk that the entity will be unable to fulfil its obligations (non-performance risk).

C3. Members were asked for their views on:

(a) which of these two rates provides the more accurate depiction of an asset decommissioning or environmental rehabilitation provision;

(b) how an entity might quantify the non-performance risk associated with such a provision; and

(c) what costs an entity might incur in quantifying that risk, calculating the required risk adjustment and disclosing information about the adjustment.

C4. One member reported that his company has environmental (closure) liabilities relating to its mining activities. His company uses a risk-free discount rate, and he would like it to continue to do so. Risk-free rates are observable, whereas rates that include non-performance risk require more judgement and could lead to more variability in the discount rates used. His company commits to environmental rehabilitation—non-performance is a minor risk relative to the other uncertainties in the estimate, and he would be unsure of how to quantify it, or how to justify an estimate to an auditor. Furthermore, reporting changes in non-performance risk could be self-incriminating.

C5. Other members also said they would prefer IAS 37 to require a risk-free discount rate. Their reasons included that:

(a) risk-free rates are observable so can be determined objectively. In contrast, the non-performance risk associated with a provision is subjective—the adjustment would be difficult to estimate and audit. Quantifying non-performance risk would sometimes require outside expertise, which could be costly and time-consuming. The cost and effort required would be unwarranted for an adjustment that will reverse over time as the discount unwinds.

(b) IAS 37 requires an entity to report its obligations, not its ability or intentions to fulfil those obligations. References to risk in IAS 37 relate to uncertainty about the resources that will be required to settle a provision. The entity's own creditworthiness is not a factor in assessing that uncertainty.

(c) the outcomes of incorporating non-performance risk into the discount rate are counterintuitive—entities with a poor credit rating report smaller liabilities and those with weakening credit ratings report gains and increases in shareholder wealth. For this reason, other IFRS Accounting Standards—for example, IAS 19 Employee Benefits—require discount rates that exclude entity-specific non-performance risk.

(d) decommissioning and environmental provisions often carry a low risk of non-performance. Such liabilities are difficult to avoid—they transfer with businesses and assets to new owners. Furthermore, non-performance risk might be mitigated by performance guarantees, which are reported separately as contingent liabilities, so the discount rate should reflect only the time value of money. Non-performance risk is less important than the other drivers of uncertainty in the measure of a provision—adjusting for that risk implies a degree of precision in the measure that does not exist.

(e) investors need information that helps them assess an entity's ability to finance its obligations, but there are better ways of providing that information than forcing it into an adjustment to a single number on the statement of financial position. Investors struggle to understand non-standard discount rates. Investors are best served if entities apply a straightforward, transparent and consistent approach to calculating a provision. Two members said that, in their experience, most investors would rather make their own assessment of an entity's credit risk than rely on the entity's calculations.

(f) asset decommissioning and environmental rehabilitation activities are operating costs. Increasing discount rates to reflect non-performance risk results in a proportion of an entity's operating costs being reclassified as a finance expense, which inappropriately flatters the operating result.

(g) many entities use risk-free rates to discount provisions and the arguments for requiring rates to include non-performance risk are not strong enough to overturn such a widespread practice.

C6. One member expressed a view that whether non-performance risk is reflected in a discount rate might depend on the facts and circumstances. For example, it might be appropriate to include non-performance risk if that risk would be considered in reaching a cash settlement with the counterparty. However, for most provisions within the scope of IAS 37, a counterparty is unlikely to accept a price adjustment made to take non-performance risk into account.

C7. One member suggested that the discount rates for provisions be calculated on the same basis as discount rates for pension liabilities. The member stated that the cash flow projections required for environmental provisions are similar to those required for defined benefit pension obligations, and that the rates used to discount pension obligations are audited and readily available to preparers of financial statements. The member also cautioned that requiring different discount rates for different types of liability would create unwelcome complexity.

*Disclosure of information about discount rates used*

C8. The staff explained that some investors have asked the IASB to add to IAS 37 a requirement for entities to disclose more information about the rates they use to discount provisions. Investors have suggested requiring entities to disclose the rates used, the basis on which the rates are determined, the undiscounted cash flows and assumptions made about the timing of the cash flows. Investors have also suggested that, if entities use discount rates that reflect non-performance risk, they be required to provide information about the effect of the non-performance risk on the rates used and a sensitivity analysis.

C9. Members were asked for their views on the costs of providing those types of information.

C10. One member said disclosing information about an entity's assessment of its own non-performance risk could be challenging, and potentially damaging to the entity. Furthermore, it is unnecessary to add to IAS 37 requirements to disclose this type of information. Other IFRS Accounting Standards—for example, IFRS 7 Financial Instruments: Disclosures—require entities to provide the information investors need to make their assessments of the risks affecting an entity's ability to remain as a going concern. Another member agreed with these comments.

C11. Some members reported that their companies already provide some of the information investors have said they would like all entities to provide. One member said his company discloses the range of rates it uses to discount provisions. Another member said his company's closure liabilities are such a large proportion of its total liabilities that the company already discloses:

(a) the sensitivity of the measure of those liabilities to a 1% increase or decrease in the discount rate; and

(b) the undiscounted cash flows and estimates of their timing, as part of the management discussion and analysis section of the annual report.

C12. One member said he thought a requirement for a sensitivity analysis might lead to unnecessarily detailed information—analysts do their own stress tests.

# Appendix D—EXTRACT FROM Meeting Summary—Accounting Standards Advisory Forum 8–9 December 2022

## ASAF members who attended the meeting

| Region | Members |
|---|---|
| Africa | Pan African Federation of Accountants (PAFA) |
| Asia-Oceania (including one at large) | Asian-Oceanian Standard-Setters Group (AOSSG)*<br>Accounting Standards Board of Japan (ASBJ)<br>Accounting Regulatory Department, Ministry of Finance PRC (ARD)*<br>Korea Accounting Standards Board (KASB) |
| Europe (including one at large) | European Financial Reporting Advisory Group (EFRAG)*<br>Autorité des normes comptables (ANC)<br>UK Endorsement Board (UKEB)<br>Accounting Standards Committee of Germany (ASCG) |
| The Americas | Group of Latin American Accounting Standard Setters (GLASS)*<br>Canadian Accounting Standards Board (AcSB)<br>Financial Accounting Standards Board, United States (FASB) |

* Remote participation via videoconference

## Provisions—Discount rates

D1. In this session, ASAF members provided views on:

(c) discount rates for provisions:

(i) whether the IASB should amend IAS 37 to specify the treatment of non-performance risk (paragraphs D2–D4);

(ii) if so, which of nine factors already identified by the IASB should carry most weight in deciding whether to require or to prohibit the inclusion of non-performance risk (paragraphs D5–D10); and

(iii) whether the IASB should consider other factors (paragraphs D11–D13); and

(d) disclosure of information about rates used to discount provisions:

(i) whether the IASB should add to IAS 37 a requirement to disclose information about rates used (see paragraph D14); and

(ii) if so, what information IAS 37 would require an entity to disclose (paragraphs D15–D17).

### *Discount rates for provisions*

#### *Whether to specify the treatment of non-performance risk*

D2. The GLASS, AOSSG, EFRAG, KASB, UKEB and FASB members said they (or most of members of their group) agreed that the IASB could reduce diversity in practice by amending IAS 37 to specify the treatment of non-performance risk.

D3. The AcSB and ANC members suggested that specifying the treatment of non-performance risk might be unnecessary—enhanced disclosure requirements might be enough to allow investors to compare the amounts reported by entities using rates calculated on different bases. The AcSB member said diversity in practice among Canadian entities is unproblematic for investors because Canadian entities disclose extensive information about the rates they have used. The PAFA member said the same was true in his region. He said a bigger problem is the lack of guidance from the IASB on the starting point for calculating the discount rate. Without such guidance, IAS 37 is difficult to apply and creates tension between preparers of financial statements and their auditors. Amendments to IAS 37 would be most helpful if they clarified the starting point. The FASB member agreed that amendments would be worthwhile if they helped to clarify IAS 37, reducing costs and complexity.

D4. Some ASAF members commented on whether discount rates for provisions should include or exclude non-performance risk. The GLASS and AOSSG members said the majority of their members think non-performance risk should be excluded. The ARD member said most of its stakeholders think non-performance risk should be included. The EFRAG and ASCG members reported mixed views among their stakeholders.

*Which of the nine factors identified by the IASB should carry most weight in the decision?*

D5. Several members commented on the measurement uncertainty associated with estimates of non-performance risk. The GLASS, AOSSG, EFRAG, ASCG, KASB, UKEB and ARD members reported concerns that a requirement to estimate non-performance risk could be complex or challenging to operationalise, or that the subjectivity of the measures could lead to loss of comparability. The ASCG member questioned whether adding another subjective estimate to the calculation of an already very uncertain measure would improve the information provided to investors. The GLASS member suggested that investors could make their own assessments of non-performance risk if they wished to include it in their analysis. The ANC member said concerns about measurement uncertainty are less compelling now than they were 10 or 20 years ago—preparers of financial statements have become more familiar with estimating credit risk as a result of applying IFRS 9, and entities applying US GAAP manage to estimate credit-adjusted discount rates. The FASB member said that entities applying US GAAP estimate a credit-adjusted rate only on initial recognition—the rate is not updated thereafter. The UKEB member said, although an entity's credit risk might be relatively easy to measure, other components of non-performance risk—for example, regulatory, operational and commercial risks—are harder to measure.

D6. The ANC, UKEB and ARD members stressed that alignment with the *Conceptual Framework* is an important factor.

D7. The EFRAG and ASCG members acknowledged the conceptual arguments for including non-performance risk. The AcSB member said non-performance risk can be a major economic issue in some jurisdictions—for example, Canada has a problem with oil wells that become 'orphaned' when their owners are unable to decommission them.

D8. The ANC, AcSB, ARD and FASB members referred to the need to give weight to user needs. The AOSSG, UKEB, ASCG and FASB members referred to concerns about the counterintuitive effects of changes in non-performance risk. The UKEB and FASB members said those effects could be difficult for investors to understand. The ANC member said the IASB had allayed these concerns in IFRS 9 through requirements to present the effects of changes in non-performance risk in other comprehensive income, instead of in profit or loss. The AOSSG member referred to a concern from one of its members that recognising changes in non-performance risk (whether in profit or loss or in other comprehensive income) would add complexity for both users and preparers and possibly hinder the useability and usefulness of information in financial statements.

D9. The AOSSG, ASBJ and KASB members referred to the differences between provisions and other liabilities. The AOSSG member said the measurement objective of IAS 37 differs from the measurement objective of other IFRS Accounting Standards.

D10. The KASB, UKEB and ARD members referred to the intentions of the International Accounting Standards Committee (IASC) when it developed IAS 37, with the ARD member stating that non-performance risk is 'specific to the liability'. The UKEB member said the rate specified should be consistent with the measurement objective specified by the IASC—the best estimate of the expenditure required to settle the provision.

*Other factors the IASB should consider*

D11. The AcSB member suggested the IASB consider the discount rates required by other IFRS Accounting Standards—preparers, users and auditors of financial statements complain more about differences between the rates required for different types of assets and liabilities than about variations in the rates used by entities for provisions. The ASBJ member said discount rates might need to vary among IFRS Accounting Standards because the types of cash flows being discounted also vary—the Japanese domestic accounting standard for asset decommissioning provisions requires those provisions to be discounted using a risk-free rate, and the major reason is the difference between the cash flows required to settle a provision and those required to settle other liabilities. The UKEB member said, although the discount rate required by IAS 37 need not be the same as those required by other IFRS Accounting Standards, the IASB should be able to explain clearly why it differs from the rates required by other IFRS Accounting Standards—in particular, the rates required by IFRS 17 *Insurance Contracts* and IAS 19 *Employee Benefits*.

D12. The ANC member suggested the IASB consider aligning IAS 37 and IFRS 3 *Business Combinations*. Including non-performance risk would reduce the need for post-acquisition adjustments to the carrying amount of provisions assumed in business combinations.

D13. The ANC member also suggested the IASB consider the implications of funding requirements for some type of provisions. He said some European jurisdictional authorities specify or cap the discount rates that entities in some sectors use when applying IAS 37 to measure funded asset decommissioning provisions.

### *Disclosure of information about rates used to discount provisions*

#### *Whether to add to IAS 37 a requirement to disclose information about rates used*

D14. ASAF members said they thought IAS 37 should require an entity to disclose information about the rates it uses to discount provisions. In explaining that view:

(a) the KASB and AOSSG members said the overarching requirements in IAS 1 Presentation of Financial Statements are too imprecise.

(b) the AcSB member said investors need to be able to compare the discount rates entities have used to measure impairment losses with those they have used to measure decommissioning provisions. Using a lower rate to measure provisions can shield the entity from recognising an impairment loss.

(c) the ANC member suggested that without a clear consensus on whether to require or prohibit the inclusion of non-performance risk, enhancing disclosure requirements could be a first step in the IASB alleviating the comparability problems created by diversity in practice.

*What information IAS 37 should require an entity to disclose*

D15. ASAF members said, as requested by investors, IAS 37 should require an entity to disclose the discount rates it has used, the basis for determining those rates, the undiscounted cash flows and the assumptions made about the timing of those cash flows.

D16. Some ASAF members added further suggestions and observations:

(a) the FASB member said investors often want to do their own analysis. The information they had requested was the minimum they would need for such analysis.

(b) the ASBJ member suggested that investors might need less information about the basis for determining a discount rate if IAS 37 required an entity to use a risk-free rate, as opposed to a rate that included non-performance risk. However, the ANC member said even risk-free rates—especially those for very long-term provisions—are hard to observe and might be subject to significant measurement uncertainty. The member suggested the IASB require an entity to disclose how it has estimated an appropriate risk-free rate.

D17. ASAF members also discussed the additional information that investors had requested if discount rates included non-performance risk—a disaggregation of the provision to identify the effect of the non-performance risk adjustment on the amount recognised, and information quantifying the sensitivity of the amount recognised to variations in estimates of the discount rate (a sensitivity analysis). ASAF members had mixed views on requirements to disclose these types of information:

(c) the AOSSG, GLASS and EFRAG members said their group members accepted that a sensitivity analysis would be useful if discount rates include non-performance risk. However, the AOSSG member also reported a view that the costs might outweigh the benefits.

(d) the ASCG member was unsure about a requirement for a sensitivity analysis, stating that a decommissioning provision is sensitive to many factors other than (and possibly more important than) the discount rate—for example, the amount and timing of the cash flows and rates of price inflation. Information quantifying the sensitivity of the provision to variations in all these (potentially interrelated) factors could be very complicated.

(e) the UKEB member said UK companies with large long-term provisions already provide sensitivity analyses, so a requirement to provide them would impose only minimal cost or effort on these companies. However, a requirement to disaggregate a provision could be costly and burdensome—it would be important for the IASB to word the requirement in a way that ensured an entity disclosed the information only when it was material. The ASBJ member suggested that a sensitivity analysis might be necessary only for entities with very large long-term provisions—for example, entities in the oil and gas, mining and power generation sectors.

(f) the FASB member suggested the IASB ask investors how they would use the additional information about the effects of non-performance risk on the provision. If investors would use the information to ‘back out’ the entity’s estimate of the effects of non-performance risk, the benefits of requiring companies to include non-performance risk might be outweighed by the costs and complexity of calculating the risk adjustment and disclosing information about its effects.