Staff paper

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IASB® meeting

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Project	**Provisions—Targeted Improvements**
Topic	**Discount rates—stakeholder feedback**
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Session overview

1. In this session, the IASB will discuss stakeholder feedback on discount rates for provisions within the scope of IAS 37 *Provisions, Contingent Liabilities and Contingent Assets*—specifically, feedback on whether the risks reflected in the rate should include non-performance risk.

2. This paper includes:
   (a) background information on the requirements of IAS 37, the project objectives, and work done to date (paragraphs 4–15):
   (b) a summary of feedback from:
      (i) users of financial statements (paragraphs 16–25);
      (ii) preparers of financial statements (paragraphs 26–36);
      (iii) national standard-setters (paragraphs 37–42);
   (c) a staff analysis of the implications of the stakeholder feedback—identifying four options for possible amendments to IAS 37 (paragraphs 43–59): and
   (d) staff suggestions for next steps (paragraph 60–61).

3. IASB members will be asked to comment on the stakeholder feedback and the four options and next steps suggested by the staff. The IASB will not be asked to make any decisions.

Background information

IAS 37—requirements and application in practice

4. IAS 37 requires an entity to discount a provision to its present value if the effect of the time value of money is material. The effect is most likely to be material for large long-term provisions—typically, the asset decommissioning and environmental rehabilitation provisions recognised by entities operating in the power generation, oil & gas, mining and telecommunications sectors.

5. IAS 37 requires an entity to discount a provision at a rate that reflects:

   (a) current market assessments of the time value of money; and

   (b) the risks specific to the liability, to the extent that those risks are not reflected in the cash flows.

6. The risks specific to the liability include the uncertainty in the cash flows required to settle the liability. Reflecting this type of risk typically increases the amount at which a liability is measured. It can be reflected by *increasing* the estimates of the cash outflows required to settle the liability, or by *decreasing* the discount rate. In practice, entities tend to reflect this risk by increasing the estimates of the cash outflows, not by decreasing the discount rate.

7. IAS 37 does not specify whether the risks specific to the liability also include non-performance risk—the risk that the entity will not fulfil its obligation. Reflecting non-

performance risk decreases the amount at which a liability is measured. It is reflected by *increasing* the discount rate.

8. In the absence of specific requirements in IAS 37 on whether and how to reflect non-performance risk, practice varies:

   (a) some entities do not reflect non-performance risk. Their stated accounting policy is to apply a risk-free rate and they typically use the yield on an appropriate government bond as an observable market proxy for that rate (see the note on terminology below).

   (b) some entities state that they apply a 'credit-adjusted' rate. Some of those entities explain that this rate reflects the entity's borrowing rate or credit spread.

   (c) some entities reflect the non-performance risk in a particular class (or particular classes) of market investment, for example an AA-rated corporate bond. They reflect this risk by discounting at a rate determined by reference to the current market yield on that type of investment.

Note on terminology
Where this paper refers to 'risk-free' rates in the context of discount rates used in practice, it is referring to the observable market rates (for example, government bond yields) that entities use as proxies for risk-free rates.

Project objectives

9. As part of its project to make targeted improvements to IAS 37, the IASB is considering developing proposals to specify in IAS 37:

   (a) whether discount rates for provisions reflect non-performance risk; and

   (b) if so, how.

Previous IASB discussion

10. The IASB started discussing this topic at its October 2022 meeting. The staff paper for that meeting, Agenda Paper 12A *Provisions—Targeted Improvements—Discount rates—non-performance risk*:

    (a) explains the reasons for considering this matter; and

    (b) discusses factors that could affect views on whether the risks reflected in the discount rate for a provision should include non-performance risk.

11. The main messages in that paper are summarised in Agenda Paper 22A (Appendices) *Provisions—Targeted Improvements—Discount rates—reference information* for this meeting.

12. In the paper discussed at the IASB's October 2022 meeting, the staff present a view that:

    (a) the amount of non-performance risk associated with a provision is specific to that provision. Although it depends in part on the entity's overall credit standing, it may also depend on other factors—for example, whether the provision is funded and where the provision would rank relative to other liabilities in the event of the entity's bankruptcy. (This means that the discount rate required to reflect the non-performance risk associated with a provision is not necessarily the same as the entity's borrowing rate.)

    (b) the requirements of IAS 37 could be interpreted in two ways—permitting entities to either:

        (i) exclude non-performance risk, or

        (ii) include the non-performance risk specific to the provision being discounted.

Either of these two approaches can be justified conceptually and either approach can be argued to be consistent with the measurement objective in IAS 37. Furthermore, although the approaches differ in the types of information they provide about the entity's financial position and financial performance, each provides information that could be useful to investors.

13. The paper also notes that, 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 used in measuring provisions or the basis on which those rates have been determined.

14. IASB members discussed the factors that could affect their decision on whether discount rates for provisions should include or exclude non-performance risk. Several IASB members said that it was important for them to hear the views of users of financial statements, to find out which approach better meets the information needs of investors.

Consultation with stakeholders

15. Since that IASB discussion, the staff have sought views on this matter from a range of stakeholders, including:

    (a) users of financial statements—via the IASB's Capital Markets Advisory Committee (CMAC) and representatives of four national groups of analysts and investors (from Japan, Canada, Australia and Europe);

    (b) preparers of financial statements—via the IASB's Global Preparers Forum (GPF) and preparers representing entities operating in various jurisdictions in the power generation, oil & gas, mining and telecoms sectors; and

    (c) national standard-setters—via the IASB's Accounting Standards Advisory Forum (ASAF).

Stakeholder feedback

Users of financial statements

16. We asked users of financial statements:

    (a) whether information about provisions would be more useful if discount rates were standardised;

    (b) which rate results in more useful information—a rate that includes or a rate that excludes non-performance risk; and

    (c) whether entities with long-term provisions disclose enough information about the discount rates they have used and, if not, what further information would be useful.

CMAC members

17. As reported in more detail in the summary of the October 2022 CMAC meeting (see Agenda Paper 22A (Appendices)), CMAC members expressed differing views on whether the discount rate for a provision should include or exclude non-performance risk:

    (a) some equity analysts advocated a rate that includes non-performance risk, on the grounds the resulting measure of the provision would better reflect the economic value of the entity's liability, and would be more comparable with IFRS measures of other types of liabilities and with provisions measured applying US GAAP; but

    (b) other equity analysts and both the credit analysts commenting advocated excluding non-performance risk, on the grounds that:

(i) they need the information that will allow them to make their own assessment of non-performance risk (the amount and timing of the future outflows); and

(ii) entity-specific credit adjustments are highly subjective.

18. CMAC members suggested ways in which financial statements could satisfy the information needs of both equity and credit analysts. Suggestions included:

(a) requiring entities to measure provisions using rate that reflects non-performance risk, but also to disaggregate the measure to disclose its inputs—the undiscounted cash flows, the effect of the time value of money and the effect of the non-performance risk adjustment; or

(b) requiring entities that use a rate higher than a risk-free rate to disclose the size of the risk adjustment and provide a sensitivity analysis, identifying the effect a one percentage point change in the discount rate would have on the measure of the provision.

19. On disclosure, CMAC members suggested that:

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

(b) information about the undiscounted amount and timing of the cash flows assumed in estimating the provision would be particularly useful.

(c) 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 the 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 entity.

Other users of financial statements

20. Among the other groups of users we talked to, group members tended to say that information about provisions would be more useful if discount rates were standardised. However a few members of some groups said that they do not find differences a problem if entities disclose enough information about the rates they have used. The most useful information is the amount and timing of the undiscounted cash flows.

21. The groups expressed varying views on what the standardised rate should be:

    (a) among the members of the Japanese and Australian groups, there was a general consensus in favour of a risk-free rate; but

    (b) among the members of the European and Canadian groups, views were more divided. Whilst some members said they favoured a risk-free rate:

        (i) some members of both groups said they favoured a credit-adjusted rate, on the grounds that the measure of the provision would better assist in the valuation of the entity—it would better approximate the fair value of the entity's obligation and be more comparable with the measure of other liabilities;

        (ii) one European analyst expressed a view that the rate for provisions should be the same as that for insurance contract liabilities—on the grounds that provisions, like insurance contracts, are illiquid and so should be discounted at a rate that includes an illiquidity premium;

        (iii) one Canadian analyst said that it would be helpful if the IASB minimised differences among the discount rates requires by IFRS Standards. He suggested the rate used to discount provisions for asset decommissioning obligations should be the same as the rate used to measure impairment (if any) of the related assets.

22. Those who said they would prefer entities to use a risk-free rate tended to do so for two main reasons:

    (a) a risk-free rate can be approximated using an observable market rate, such as the yield on government bonds. In contrast, an entity-specific non-performance risk adjustment is not observable and highly subjective, impeding comparability.

    (b) the results of measuring a provision at an amount that reflects the entity's own credit standing are counter-intuitive—an entity with a poor credit rating would report smaller obligations than an entity with a stronger credit rating, and an entity with a deteriorating credit rating would report a reduction in its liabilities.

23. Other reasons given were that:

    (a) financial statements should reflect an entity's obligations. Reducing the measure of a provision to reflect the possibility that the entity might default is illogical (one analyst said 'insane').

    (b) in reality, companies cannot avoid asset decommissioning and environmental obligations—society requires them to fulfil those obligations, and in some jurisdictions the obligations rank higher than other liabilities in a liquidation.

24. A Japanese analyst suggested that, if the IASB decides not to standardise the rates used to discount provisions, or to require entities to include non-performance risk, it should enhance disclosure requirements. Japanese analysts suggested requiring disclosure of the undiscounted cash flows, information about the adjustments that reconcile the rate used to a risk-free rate and a sensitivity analysis.

25. On disclosure, the users we consulted tended to agree with the list of disclosure requirements suggested by CMAC members (see paragraph 19).

Preparers of financial statements

GPF members

26. As reported in more detail in the summary of the November 2022 GPF meeting (see Agenda Paper 22A (Appendices)), most GPF members said that they would prefer IAS 37 to require provisions to be discounted using a risk-free rate. Their reasons were 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.

    (b) entities publicly commit to environmental rehabilitation—reporting changes in non-performance risk could be self-incriminating.

    (c) IAS 37 requires an entity to report its obligations, not its ability or intentions to fulfil those obligations.

    (d) the outcomes of incorporating non-performance risk into the discount rate are counterintuitive.

    (e) decommissioning and environmental provisions often carry a low risk of non-performance. 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.

    (f) investors struggle to understand non-standard discount rates—they are best served if entities apply a straightforward, transparent and consistent approach to calculating a provision.

    (g) 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.

(h) 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.

27. One member suggested that the discount rates for provisions be calculated on the same basis as discount rates for pension liabilities. The member said 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 creates unwelcome complexity.

Other preparers of financial statements

28. We asked several preparers—and groups of preparers—representing entities the power generation, oil & gas, mining and telecoms sectors:

(a) the basis on which they determine the rates they used to discount asset decommissioning and environmental rehabilitation provisions;

(b) why they use that basis, and how they would view a requirement to use a different rate—that is, to use a rate that includes non-performance risk if they currently exclude it, or vice versa.

29. Some preparers said their entity's accounting policy is to discount provisions at a risk-free rate. All those entities use the yield on an appropriate government bond as a proxy for a risk-free rate. They use that rate, and would not favour a requirement to adjust the rate for non-performance risk, because:

(a) the yield on a government bond readily obtainable and objective. Any adjustment for non-performance risk would be judgemental and complex—the process of determining it would be arbitrary, increasing costs for preparers and impeding comparisons.

(b) the regulations around asset decommissioning and environmental rehabilitation obligations often seek to minimise non-performance risk, for example by requiring entities to deposit funds to settle the obligations in escrow accounts. Consequently, the non-performance risk associated with an asset decommissioning provision would be difficult to measure and is likely to be small. A risk-free rate is consistent with the going concern assumption.

(c) an asset decommissioning provision is not an external borrowing. The entity does not pay the counterparty for accepting non-performance risk.

(d) the counterparty to an asset decommissioning obligation cannot sell its rights so the effect of non-performance risk on the value of those rights is not relevant information.

(e) it is not the job of financial statements to quantify an entity's credit risk—markets assess that risk using other information provided in financial statements.

30. Several preparers said that their entities use a 'credit-adjusted' rate. Those who explained how they measured that rate referred to either using their entity's (incremental) borrowing rate or adding their entity's credit spread to a risk-free rate. None said that they seek to measure the non-performance risk specific to the provision.

31. Those who explained why they use a credit-adjusted rate said they did so:

(a) to be consistent with peers that apply US GAAP;

(b) because their largest provision is in a US subsidiary—so it is simplest to use for IFRS reporting the rate required for US GAAP reporting; or

(c) because asset decommissioning obligations are legal obligations so, in their view, should be discounted at a debt-like rate.

32. An entity operating in the oil & gas sector determines the rate it uses to discount its asset decommissioning provisions on the same basis as it determines the rate it uses to discount its pension obligations—by reference to the yield on AA-rated US corporate bonds. The preparer of that entity's financial statements said that:

    (a) the use of a rate determined by reference to an observable market rate reduces complexity and subjectivity, and avoids long debates with auditors over the calculation of a rate determined by internal modelling; and

    (b) the use of the rates determined on the same basis for pension and asset decommissioning obligations further reduces complexity and aids communication with investors.

33. A nuclear power generating entity uses a rate that comprises:

    (a) a sovereign yield curve constructed on year-end market data for liquid horizons and then converging, using an interpolation curve, towards the very long-term Ultimate Forward Rate[1]; plus

    (b) a curve of the spread of corporate bonds rated A to BBB.

34. Of the preparers using rates higher than risk-free rates, some said they and their peers would oppose a requirement to use risk free rates. They argued that:

    (a) for some entities, even in the oil & gas, mining and telecoms sectors, the choice of discount rate is not one of the most significant factors affecting their reported financial performance and financial position. These entities prefer the simplicity of an observable government bond rate.

    (b) for other entities in those sectors and for entities in the power (especially nuclear power) generation sector, the effects of the difference between a

[1] The UFR was defined by the European Insurance and Occupational Pensions Authority (EIOPA) for very long-term insurance liabilities that will involve disbursements beyond market horizons.

credit-adjusted rate and a risk-free rate are significant. These entities believe there are good reasons for using rates higher than risk-free rates and a requirement to use a risk-free rate would not be justified.

35. Some of these preparers suggested the IASB continue to allow some flexibility but require disclosure of more information about the rates used.

36. On disclosure, the preparers expressed a general willingness to disclose the types of information requested by CMAC members (see paragraph 19). Several of them said that they already disclose much or all of that information, including sensitivity analyses. However, a few preparers queried the value of providing information about the sensitivity of an asset decommissioning or environmental rehabilitation provision to discount rates (rather than to other assumptions). They said that the assumptions about the amount and timing of the future cash outflows are sources of much greater uncertainty.

National standard-setters—ASAF

37. ASAF members were asked to consider nine factors that could affect the IASB's conclusions on whether the risks reflected in the discount rate for provisions should include non-performance risk.

38. ASAF members provided views on

    (a) whether the IASB should amend IAS 37 to specify the treatment of non-performance risk;

    (b) if so, which of the nine factors already identified by the IASB should carry most weight in its decision on whether the risks reflected in the discount rate should include non-performance risk; and

    (c) whether there are other factors the IASB should consider.

39. As reported in more detail in the summary of the December ASAF meeting (see Agenda Paper 22A (Appendices)):

    (a) most ASAF members commenting said they agreed with reducing diversity in practice by amending IAS37 to specify the treatment of non-performance risk.

    (b) two ASAF members suggested that specifying the treatment of non-performance risk might be unnecessary—enhanced disclosure requirements might be enough to allow users of financial statements to compare the amounts reported by entities using rates calculated on different bases. The member from the Canadian Accounting Standards Board expressed a view that diversity in practice among Canadian entities is unproblematic for investors because Canadian entities disclose extensive information about the rates they have used.

    (c) one ASAF member said that in his view a lack of clarity regarding the treatment of non-performance risk is not the biggest problem in determining discount rates for provisions.

40. Two ASAF members said they would prefer the risks reflected in the discount rate to exclude non-performance risk, one said it would prefer the risks to include non-performance risk, and two reported mixed views among their stakeholders.

41. Commenting on the nine factors that could affect the IASB's decision:

    (a) seven ASAF members agreed with 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. However, one ASAF member responded with a view that concerns about measurement uncertainty in performance risk adjustments 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.

(b) four ASAF members referred to the need to give weight to investor information needs. Four members referred to concerns about the counterintuitive effects of changes in non-performance risk, two saying that these effects could be difficult for investors to understand.

42. Some ASAF members suggested the IASB also consider factors not identified in the staff paper discussed at the IASB's October 2022 meeting:

(a) one ASAF member suggested the IASB consider the discount rates required by other IFRS Accounting Standards—on the grounds that 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. In response, other ASAF members expressed a view that discount rates might need to vary between Standards because the types of cash flows being discounted also vary. However, one said the IASB needs to be able to explain clearly why the rate for provisions differs from the rates required by IFRS 17 *Insurance Contracts* and IAS 19 *Employee Benefits.*

(b) one ASAF member suggested the IASB consider the implications of requirements in some jurisdictions for entities to fund some types of provisions—for example, asset decommissioning obligations.

Implications of the stakeholder feedback

43. In the light of the stakeholder feedback, the staff have identified four possible ways in which the IASB could propose to amend IAS 37 to improve the comparability of measures of provisions. The IASB could propose:

    (a) to standardise discount rates used by:

        (i) specifying that the risks reflected in the discount rate *include* the non-performance risk specific to the provision (see paragraphs 44–45);

        (ii) specifying that the risks reflected in the discount rate *exclude* non-performance risk (see paragraphs 46–49); or

        (iii) requiring a specified market-based rate that reflects the time value of money and some non-performance risk (see paragraphs 50–54); or

    (b) to enhance disclosure requirements without also standardising the discount rates used (see paragraphs 55–59).

Option 1—specify that the risks include the non-performance risk specific to the provision

44. At present, IAS 37 requires a discount rate that reflects the risks specific to the liability. The IASB could propose to add a statement specifying that the risks specific to the liability *include* the non-performance risk specific to the provision.

45. Although such a requirement would standardise practice, has a sound conceptual basis and would be the means of achieving a measure of the provision that is closest to its economic value, we think it could be problematic. We found no evidence that *any* entities at present use a discount rate for a provision that reflects the non-performance risk specific to that provision, and feedback from stakeholders suggests that:

(a) preparers of financial statements would find such a requirement complex and onerous to apply. The non-performance risk adjustment would be difficult to determine and quantify—it is not observable. Furthermore, because the non-performance risk associated with a provision could be different from the credit risk associated with the entity's borrowings, the entity's observable borrowing rate would not necessarily serve as a reasonable proxy.

(b) the information provided would not be useful to many users of financial statements:

    (i) liability-specific non-performance risk adjustments are highly subjective~~.~~. Furthermore, entities might not wish to disclose information about non-performance risk that could be self-incriminating. So, although accounting policies might become more standardised, the provisions measured applying those policies might be less, not more, comparable than they are at present.

    (ii) some users of financial statements said that if a liability cannot be traded, the information provided by including the effects of non-performance risk in the measure of that liability is not relevant, and the effects are counter intuitive.

Option 2—specify that the risks exclude non-performance risk

46. The IASB could propose to add a statement specifying that the risks specific to the liability *exclude* non-performance risk. Entities could discount their provisions using an observable market-based proxy for a risk-free rate—for example, the yield on an appropriate government bond.

47. The main arguments supporting such a requirement could be that:

    (a) it results in information that is more useful:

        (i) as reported in paragraph 20, the users we consulted tended to say that information about provisions would be more useful if rates were standardised; and

        (ii) as reported in paragraphs 17(b) and 22, some of those users said that the measure of a provision is more useful if it excludes the effects of entity-specific non-performance risk—they find useful the information that will allow them to make their own assessment of non-performance risk (the amount and timing of the future outflows), entity-specific credit adjustments are highly subjective (impeding comparability) and their effects are counter intuitive.

    (b) as described further in Appendix A, and supported by the comments of preparers that use a risk-free rate (see paragraph 29), risk-free rates are observable so can be determined objectively and avoid the cost and complexity of determining the adjustment required to reflect non-performance risk.

    (c) as described further in Appendix A, a requirement to apply a risk-free rate has a sound conceptual basis, is consistent with the measurement objective of IAS 37 and reflects the fact that entities do not pay the counterparty to accept (and so do not incur an expense for) the non-performance risk associated with a provision.

48. However, there would be costs resulting from requiring all entities to apply risk-free rates. At present, many entities use credit-adjusted rates—including some of the entities whose reported financial performance and financial position could be most significantly affected by the choice of discount rate. A requirement to instead apply a risk-free rate could have significant practical implications for those entities. And as indicated by the feedback reported in paragraph 34, those entities might not regard the

change as justified—especially because it results in a measure of a provision that could be greater than the provision's fair value, and increases the differences between IFRS and US GAAP measures of provisions.

49. The hurdle for amending the requirements of IFRS Accounting Standards is high—the IASB needs to have strong evidence that the benefits outweigh the costs. The feedback we have received to date from users of financial statements suggests that many of them would benefit from a requirement for discount rates to exclude non-performance risk. But that feedback is perhaps not overwhelming enough for the IASB yet to be sure that overall the benefits would exceed the costs.

Option 3—require a rate determined by reference to a specified market rate

50. As a compromise between a requirement to exclude all non-performance risk and a requirement to include the non-performance risk specific to the provision, the IASB could propose a requirement to use a rate determined by refence to a specified market rate that reflects some non-performance risk—for example, the current market yield on a specified class of corporate bonds.

51. In favour of such a requirement, it could be argued that:

    (a) as reported in paragraph 20, the users we consulted tended to say that information about provisions would be more useful if rates were standardised.

    (b) among the users expressing a preference for a risk-free rate, the most frequently-cited reasons were concerns about the subjectivity and counterintuitive effects of an entity-specific credit risk adjustment (as described in paragraph 22). A requirement to use a rate determined by reference to a market rate (even one that reflects some non-performance risk) would avoid those concerns.

(c) of the preparers expressing a preference for a risk-free rate, the main reason given was a desire to avoid the cost and complexity of determining the adjustment required to reflect the non-performance risk specific to the provision. A requirement to use a rate determined by reference to a market rate (even one that reflects some non-performance risk) would avoid that cost and complexity.

52. The IASB could consider bases for determining discount rates required by IFRS Accounting Standards for other liabilities. Specifying a basis for provisions that is the same as or similar to one required by another Standard would respond to an ASAF member's experience (reported in paragraph 42(a)) that 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.

53. A possible candidate could be a rate similar to that required by IAS 19 for pension obligations. Asset decommissioning and environmental rehabilitation provisions have several characteristics that are similar to those of pension obligations—for example, they can have long durations, the cash flows required to settle them can be very uncertain, and the obligations may be funded by high-quality low-risk investments. It could be argued that aligning the discount rate requirements in IAS 37 with those in IAS 19 would promote greater consistency in the measurement of long-term obligations. And, as one preparer confirmed (see paragraph 32), the use of rates determined on the same basis for pension and asset decommissioning obligations can reduce complexity for preparers of financial statements and aid communication with investors.

54. IAS 19 requires entities to discount post-employment benefits (both funded and unfunded) by reference to market yields on high quality corporate bonds (or, for a currency for which there is no deep market in such bonds, the market yields on

government bonds in that currency).[2] A possible disadvantage of a requirement to determine the discount rate for provisions by reference to the market yields on investments other than government bonds could be the overall costs of transition—more entities would have to change their accounting policy to implement this requirement than would have to change their accounting policy to implement a requirement to use a risk-free rate. As we reported in Chapter 4 of the staff paper for the IASB's October 2022 meeting, companies that disclose the basis on which they determine the rates typically refer to risk-free rates, government bond yields or 'credit-adjusted' rates. This suggests that at present very few entities use rates determined by reference to the yields on high quality corporate bonds.

Option 4—strengthen disclosure requirements without also standardising rates used

55. As reported in paragraph 39(b), two ASAF members suggested that standardising discount rates for provisions might not be necessary—enhanced disclosure requirements might be enough to allow users of financial statements to compare the amounts reported by entities using rates determined on different bases. And, as reported in paragraph 20, a few users of financial statements also said that they did not find differences in discount rates a problem if entities disclosed enough information about the rates they had used.

56. Furthermore, standardising discount rates might achieve only a marginal improvement in the usefulness of the information that entities provide about an asset decommissioning or environmental rehabilitation provision. The long-term nature of many of these provisions, and their lack of a clear maturity date, means that both the amount and timing of the undiscounted cash flows are subject to a high degree of measurement uncertainty. Regardless of the discount rate applied in measuring the

[2] Paragraph 83 of IAS 19 *Employment Benefits*

provision, entities might need to disclose extensive additional information for users to fully understand the uncertainties affecting the future cash flows.

57. So a fourth option could be to propose to strengthen disclosure requirements in IAS 37 without also proposing to standardise the discount rates entities use.

58. The IASB could propose to require entities to disclose information that reflects the types of information CMAC members said they find useful (see paragraph 19), for example:

    (a) the discount rates used, and a description of the basis used to determine these rates.

    (b) the undiscounted amount and timing of the cash flows (the cash flow profile).

    (c) if the rates used are higher than risk-free rates:

        (i) the reasons for using higher rates, the logic followed in calculating the rates, and the effect of any adjustments made to market rates; 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 entity.

59. As a means of enhancing comparability, strengthening disclosure requirements could be less effective on its own than in combination with standardising discount rates. The IASB might wish to consider the ‘disclosure only’ option only if it thinks it would have difficulty in achieving a consensus in favour of one of the other three options or that the benefits of standardising rates would not be great enough to outweigh the costs.

Next steps

60. The staff could analyse and further develop some or all of these four options—and any other options that IASB members identify—for further consideration and tentative decisions at a future meeting.

61. If IASB members would like us to further develop the option of requiring a rate determined by reference to a specified market rate (Option 3), we would investigate the practicability of specifying that rate for asset decommissioning and environmental rehabilitation obligations.

Questions for IASB members

Questions for IASB members
Do you have any comments on the stakeholder feedback, or on the four options for possible amendments and next steps suggested by staff? In particular: (a) of the four options, are there any you particularly wish the staff to develop further, or that you would prefer not to progress further at this stage, and (b) are there any options not identified in his paper that you would like the staff to analyse for future discussion?