

**EFRAG Secretariat: Didrik Thrane-Nielsen (Project Director),  
Sapna Heeralall, Robert Stojek**

This paper has been prepared by the EFRAG Secretariat for discussion at a public meeting of EFRAG FR TEG-CFSS. The paper forms part of an early stage of the development of a potential EFRAG position. Consequently, the paper does not represent the official views of EFRAG or any individual member of the EFRAG FRB or EFRAG FR TEG-CFSS. The paper is made available to enable the public to follow the discussions in the meeting. Tentative decisions are made in public and reported in the EFRAG Update. EFRAG positions, as approved by the EFRAG FRB, are published as comment letters, discussion or position papers, or in any other form considered appropriate in the circumstances.

## **IASB Project – Provisions: Targeted Improvements Cover Note**

### **Objective**

- 1 This session is to obtain EFRAG FR TEG and CFSS members' views regarding:
  - (a) discount rates used to measure long-term provisions within the scope of IAS 37 *Provisions, Contingent Liabilities and Contingent Assets*, and
  - (b) information disclosed about the rates used.

### **Project Background**

- 2 From 2015 to 2019, the IASB held its discussion on a research project to identify the IAS 37 application issues.
- 3 In January 2020, the IASB decided to add a standard-setting project to its work plan, with the objective of making three targeted improvements to IAS 37, that is to:
  - (a) align the IAS 37 liability definition and requirements for identifying liabilities with the liability definition and supporting concepts in the IASB's Conceptual Framework for Financial Reporting (Conceptual Framework);
  - (b) clarify which costs to include in the measure of a provision; and
  - (c) specify whether the rate at which an entity discounts a provision should reflect the entity's own credit risk.
- 4 In February 2022, the IASB decided to keep the project based on their assessment that efficient progress is possible.
- 5 Following that, in October 2022, the IASB initially discussed whether the rate an entity uses to discount a provision should reflect non-performance risk - that is, the risk that the entity will not fulfil its obligation. The IASB decided to consult its advisory groups before continuing its discussion and deciding on project direction.

### **Key discussion points for the session**

#### *Non-performance risk*

- 6 The IASB discussion concerns whether to require or prohibit inclusion of non-performance risk.
- 7 Other IFRS Accounting Standards, and specifically IFRS 9 *Financial Instruments*, refer to 'credit risk', which it defines as 'the risk that one party to a financial instrument will cause a financial loss for the other party by failing to discharge an obligation'. However, IFRS 13 *Fair Value Measurement* and IFRS 17 *Insurance Contracts* refer to 'non-performance risk', which is defined as 'the risk that an entity will not fulfil an obligation'. IFRS 13 states that non-performance risk includes, but

may not be limited to, the entity's own credit risk. An entity's own credit risk is often the main source of non-performance risk for a liability, and the terms 'non-performance risk', 'credit risk' and 'own credit risk' are sometimes used interchangeably. Nevertheless, the IASB discussion relates to 'non-performance risk' and understood in accordance with IFRS 13, and IFRS 17 guidance.

- 8 The existing IAS 37 guidance requires provisions to be measured at the best estimate of the expenditure required to settle the present obligation, with that expenditure being discounted to its present value if the effect of the time value of money is material. Moreover, IAS 37 requires the discount rate to reflect 'the risks specific to the liability' if those risks are not reflected by adjusting the estimates of the cash flows. However, IAS 37 does not specify whether the discount rate should reflect non-performance risk.
- 9 The IASB Staff revealed that there is a diversity across sectors and regions regarding the basis on which entities determine the discount rates the use for provisions. The inclusion of non-performance risk is sometimes viewed as an accounting policy choice.
- 10 In order to make its decision, the IASB asks about views on how to consider the following various factors that relate to measuring the discount rate:
  - (a) whether non-performance risk is specific to the liability;
  - (b) the intentions of the International Accounting Standards Committee (IASC) when it developed IAS 37;
  - (c) measurement concepts in the IASB's Conceptual Framework for Financial Reporting (Conceptual Framework);
  - (d) a difference between provisions and other liabilities;
  - (e) the measurement objective of IAS 37;
  - (f) information provided to investors;
  - (g) subsequent measurement - 'counter-intuitive' results and accounting mismatches;
  - (h) measurement uncertainty; and
  - (i) convergence with US GAAP.
- 11 For a summary, please refer to agenda paper 08-02, pages 9-11. For further details on the factors please refer to agenda paper 08-03.

#### *Disclosures on provisions*

- 12 IAS 37 has no specific requirements to disclose information about:
  - (a) the rates used to discount provisions, or
  - (b) the basis on which those rates have been determined.
- 13 The discount-rate related disclosures may be based on general provisions of IAS 1 *Presentation of Financial Statements*.
- 14 However, based on the report [Black Box Accounting: Discounting and Disclosure Practices of Decommissioning Liabilities](#), published in 2020 by ICAS, disclosure practices vary from only basic to comprehensive.
- 15 On the other hand, the investors interviewed by the IASB Staff suggested adding the following requirements to disclose:
  - (a) the rate, or range of rates, used to discount provisions;
  - (b) the basis for determining those rates:

- (i) the market investments whose yields are the basis for the discount rates and their characteristics: type, duration, country of issue;
  - (ii) whether the rates are adjusted and, if so, for what factors and with what effect
- (c) specific inputs to the calculation:
- (i) the undiscounted cash flows
  - (ii) the assumptions made about the timing of the cash flows e.g. for decommissioning provisions.
- 16 Moreover, recently, the CMAC members suggested that entities could be required to:
- (a) measure provisions using a rate that includes performance risk, and
  - (b) provide further information to enable investors to exclude includes that effect if they wish to.
- 17 Entities would be therefore required to
- (a) disaggregate the provision to separately identify:
    - (i) the undiscounted cash flows;
    - (ii) the effect of discounting those cash flows at a risk-free rate, and
    - (iii) the effect of the non-performance risk adjustment;
  - (b) provide a sensitivity analysis.

#### **Questions for EFRAG FR TEG and CFSS**

##### Non-performance risk

- 18 Do you think the IASB should develop proposals to amend IAS 37 to specify whether the discount rate for provisions includes non-performance risk?
- 19 If so, which of the factors listed in paragraph 10 you think should carry most weight in deciding whether to require or prohibit the inclusion of non-performance risk?
- 20 Are there other factors you think the IASB should consider?

##### Disclosures on provisions

- 21 Do you think the IASB should develop proposals to add to IAS 37 specific requirements to disclose information about the discount rates used to measure provisions?
- 22 If so, which of the items of information listed on pages 18 and 19 do you think entities should be required to disclose?

#### **Next steps**

- 23 Based on the feedback received, the IASB will decide on the project direction.

#### **Agenda Papers**

- 24 In addition to this cover note the following papers have been provided for background purposes:
- (a) Agenda paper 08-02 Provisions - Targeted Improvements to IAS 37 – ASAF Agenda Paper 05; and
  - (b) Agenda paper 08-03 Provisions - Targeted Improvements to IAS 37 – the October 2022 IASB meeting Agenda Paper 12A.