

## Onerous contracts: costs of fulfilling a contract (amendments to IAS 37)

Exposure draft issued for comment by the IASB

Comments from ACCA

14 April 2019

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## GENERAL COMMENTS

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ACCA welcomes the opportunity to provide views in response to the IASB's proposed amendments to IAS 37. This has been done with the assistance of members of ACCA's Global Forum for Corporate Reporting. If further information is needed, please get back to us.

## AREAS FOR SPECIFIC COMMENT

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- 1. The Board proposes to specify in paragraph 68 of IAS 37 that the cost of fulfilling a contract comprises the costs that relate directly to the contract (rather than only the incremental costs of the contract). The reasons for the Board's decisions are explained in paragraphs BC16–BC28.**

**Do you agree that paragraph 68 of IAS 37 should specify that the cost of fulfilling a contract comprises the costs that relate directly to the contract? If not, why not, and what alternative do you propose?**

We agree with the addition to paragraph 68, clarifying that contract costs comprise costs that 'relate directly to the contract.'

The existing paragraph 68 also refers to 'unavoidable costs of meeting the obligations under the contract.' The term 'unavoidable' is not defined, although the paragraph specifies that the amount would be the lower of the cost of fulfilling the contract and compensation or penalties for not fulfilling it.

It would be helpful to clarify whether the costs of fulfilling the contract need to be both unavoidable and direct, or whether 'unavoidable costs' is merely a term for the lower of the two amounts to be considered. Further examples may be needed to illustrate which costs may be considered to be unavoidable.

- 2. The Board proposes to add paragraphs 68A–68B which would list costs that do, and do not, relate directly to a contract.**

**Do you have any comments on the items listed?**

**Are there other examples that you think the Board should consider adding to those paragraphs? If so, please provide those examples.**

Paragraphs 68A and 68B are helpful, as is the exclusion of general and administrative costs.

The list of costs appear to summarise the examples previously contained in IAS 11 paragraphs 17-21, and we note they do seem consistent.

The explicit reference in paragraph 38A to 'the allocations of costs that relate directly to contract activities,' including 'depreciation of tools, equipment and right-of-use assets' as examples of costs that relate directly to a contract could lead to more divergence in

practice. This could arise, for example, when allocating depreciation where the same equipment is used for multiple projects. Examples to illustrate such cases would help preparers to apply judgement appropriately.

IFRS 15 does contain a reference to incremental costs at paragraph 91, but that relates to the costs of obtaining a contract rather than the costs of fulfilling it. It may be helpful to clarify the differences between the two types of costs in the Basis for Conclusions.

### **3. Do you have any other comments on the proposed amendments?**

#### *Transition*

We do not agree with the transitional provisions, which would prohibit the restatement of comparatives. This seems to be a departure both from the general principle in IAS 8, and from the approach adopted for IFRS 9, IFRS 15 and IFRS 16, where full retrospective restatement is an option. Allowing full retrospective restatement as an option would effectively address the concerns, described in BC33, that it may prove difficult and costly, although not impractical, for some entities. We are equally unconvinced by the IASB's view, set out in BC34, that retrospective restatement would not provide useful information.

We would recommend that the transitional provisions at least allows for the option of full retrospective restatement.

In general, it would be helpful if the IASB could establish a consistent principle around when retrospective restatements should be required, prohibited or permitted.

#### *Interactions with IFRS 15 and IAS 36*

Paragraph 69 of IAS 37 states that before recognising an onerous contract provision, the entity should impair assets dedicated to the contract in accordance with IAS 36. IAS 36 excludes IFRS 15 contract assets. IFRS 15, in turn, states that the impairment of contract assets should be preceded by the impairment of assets related to the contract that are recognised in accordance with another standard (paragraph 103). No link is made in IFRS 15 to the need to consider an onerous contract provision in accordance with IAS 37.

It would seem that better coordination and explicit cross-referencing between IFRS 15 and IAS 37 would be needed. We would recommend that IFRS 15 refers to IAS 37 in the section on amortisation and impairment.

The same set of fact patterns is likely to lead to the impairment of the cash-generating unit under IAS 36, the impairment of contract assets under IFRS 15, the impairment of other related assets under other standards (for example IAS 2, IAS 16 and IAS 38), as well as the recognition of an onerous contract provision under IAS 37. We would recommend that the IASB provides clearer guidance on the interactions between these different standards.

The interactions between asset impairment and the onerous contract provision give rise to counter-intuitive outcomes. Impairing the assets before recognising the onerous

contract reduces the depreciation on these assets, and consequently also reduces the directly-related costs that are allocated to the onerous contract provision. Should the impairment be reversed in a future year, the depreciation to be factored in to the onerous contract provision will increase, thus potentially increasing the provision. As explained below, we would recommend that further thought is given to the measurement of the provision, including the effect that changes in depreciation allocated to the contract could have on the amount of provision recognised.

### *Measurement*

It is not completely clear from the Exposure Draft whether the same costs to be considered in assessing whether or not a contract is onerous should also be used in determining the amount of the onerous contract provision.

BC14 suggests that this could be the case: ‘an entity could measure an onerous contract provision by including the same costs as it used to identify the contract as onerous.’ BC23(a) seems to take this further by stating that ‘the entity would be recognising its present obligation to deliver goods or services in exchange for other economic benefits, measuring that obligation at an amount that includes all the costs of fulfilling it.’

However, this is not apparent from the existing measurement provisions in IAS 37, which merely state that ‘the amount recognised as a provision shall be the best estimate of the expenditure required to settle the present obligation at the end of the reporting period’ (paragraph 36), and that ‘the best estimate of the expenditure required to settle the present obligation is the amount that an 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’ (paragraph 37).

Despite the reasons noted in BC12-BC24, we would recommend that the IASB considers the inclusion of specific requirements relating to the measurement of onerous contract provisions. If the IASB believes that the costs considered in assessing the existence of an onerous contract should be used as a basis for measuring the provision, this should be clearly stated as a requirement.