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Onerous Contracts

Cost of Fulfilling a Contract

Cover Note

Objective

- 1 The objective of the session is to receive input from EFRAG CFSS and EFRAG TEG members on the IASB's tentative decision to amend the requirements of IAS 37 *Provisions, Contingent Liabilities and Contingent Assets* regarding measurement of a provision for onerous contract.

Background

- 2 In 2017, the IFRS Interpretations Committee (IFRS IC) received a request to clarify the requirements of IAS 37 regarding the costs an entity should consider when assessing whether a contract is onerous.
- 3 Following the IFRS IC discussion and recommendation, the IASB observed that, from January 2018, contracts that were within the scope of IAS 11 *Construction Contracts* are within the scope of IFRS 15 *Revenue from Contracts with Customers*, however, IFRS 15 includes no requirements for identifying, recognising and measuring onerous contract liabilities. Instead, entities should apply IAS 37 requirements when assessing whether a contract is onerous.
- 4 Accordingly, the IASB tentatively decided to clarify that cost of fulfilling a contract comprises the costs that **relate directly to the contract**. Furthermore, the IASB decided to provide a list of such costs, which would include:
 - (a) direct labour;
 - (b) direct materials;
 - (c) costs explicitly chargeable to the counterparty under the contract;
 - (d) other costs incurred only because an entity entered into the contract; and
 - (e) allocations of costs e.g. costs of contract management and supervision, insurance and depreciation of tools, equipment and right-of-use assets used in fulfilling the contract.
- 5 The above clarification would be consistent with the guidance on contract costs in IFRS 15.
- 6 On 13 December 2018, The IASB issued Exposure Draft ED/2018/2 *Onerous Contracts - Cost of Fulfilling a Contract: Proposed amendments to IAS 37* (the ED). The ED can be accessed on EFRAG's web page [here](#).

EFRAG's draft Comment Letter

- 7 On 25 January 2019, EFRAG issued its Draft Comment Letter on the ED (the DCL).

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- 8 In the DCL, EFRAG welcomes the IASB's efforts to clarify the requirements of IAS 37 and supports the IASB's proposal to include the examples of the costs that relate directly to a contract.
- 9 However, EFRAG notes that the proposed amendments would affect the onerous assessment not only for long-term construction contracts previously in the scope of IAS 11 but for all contracts in the scope of IAS 37 and, therefore, encourages the IASB to further assess the expected impact of the proposals.
- 10 Moreover, EFRAG questions the assertion in paragraphs BC24 and BC25 of the ED that the proposed definition of directly related costs is consistent with requirements in other IFRS Standards for the measurement of non-monetary assets and notes that the terms and labelling 'direct' or 'directly related' are commonly used in IFRS literature, but not necessarily with consistent meaning.

Questions for EFRAG CFSS and EFRAG TEG members

- 11 Do you agree with EFRAG's draft comment letter by EFRAG on IASB's Exposure Draft *Onerous Contracts - Cost of Fulfilling a Contract*?

Agenda Papers

- 12 In addition to this cover note, agenda papers for this session are:
 - (a) Agenda Paper 15-02 – EFRAG Draft Comment Letter on the IASB Exposure Draft
 - (b) Agenda Paper 15-03 – ASAF Paper 04 – Onerous contracts Cost of Fulfilling a Contract – for background only; and
 - (c) Agenda Paper 15-04 – ASAF Paper 04A – In Brief Article Onerous Contracts – for background only.