

IASB Exposure Draft ED/2018/2 Costs Considered in Assessing Whether a Contract is Onerous (Amendments to IAS 37)

Feedback to constituents – EFRAG Final Comment Letter

April 2019

This paper has been prepared by the EFRAG Secretariat for discussion at a public meeting of EFRAG TEG. 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 Board or EFRAG TEG. 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 Board, are published as comment letters, discussion or position papers, or in any other form considered appropriate in the circumstances.

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Introduction

Objective of this feedback statement

In December 2018, the IASB published Exposure Draft ED/2018/2 *Costs Considered in Assessing Whether a Contract is Onerous (Amendments to IAS 37)* (‘the ED’). This feedback statement

summarises the main comments received by EFRAG on its draft comment letter and explains how those comments were considered by EFRAG during its technical discussions leading to the publication of EFRAG’s final comment letter.

Background to the ED

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*. IFRS 15 includes no requirements for identifying, recognising and measuring onerous contract liabilities and, instead, IAS 37 *Provisions, Contingent Liabilities and Contingent Assets* provides guidance on assessing whether a contract is onerous.

As a result of this change, in 2017 the IFRS Interpretations Committee (IFRS IC) received a request to clarify what costs an entity considers when assessing whether a contract is onerous. The IFRS IC decided that the application of IFRS 15 makes clarification of the onerous contract requirements in IAS 37 both necessary and urgent and, accordingly, recommended that the IASB amend IAS = 37 to clarify the onerous contract requirements separately from the IASB’s research project on provisions.

The IASB concluded that cost of fulfilling a contract comprises the costs that relate directly to the contract and decided to provide a list of such costs.

Further details are available on the EFRAG [website](#) in the *Documents* section.

EFRAG’s draft comment letter

On 25 January 2019, EFRAG published its [draft comment letter](#) on the ED. In the draft comment letter, EFRAG welcomed the IASB’s efforts to clarify the requirements in IAS 37 regarding the assessment

of whether, in a contract, the unavoidable costs of meeting the obligations under the contract exceed the economic benefits expected to be received under it. However, EFRAG also noted 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. Consequently, EFRAG encouraged the IASB to further assess the expected impact of the proposals. EFRAG also sought information from constituents on the likely impact of the proposals that should be considered by the IASB when finalising the amendments.

Comments received from constituents

EFRAG received and considered eight comment letters from constituents. These comment letters are available on the EFRAG [website](#). Information on the respondents are in the Appendices to this Feedback Statement.

All respondents supported the IASB’s efforts to clarify the requirements of IAS 37 regarding the assessment of whether the unavoidable costs of meeting the obligations under a contract exceed the economic benefits expected to be received under that contract.

Most respondents agreed with EFRAG’s overall tentative position on the ED. However, some respondents expressed different views on some of the proposals, including that further assessment of the impact of the proposals on contracts other than those previously in the scope of IAS 11 is not needed, and that full retrospective application could be permitted.

EFRAG’s final comment letter

EFRAG issued its final comment letter on **XX April 2019**.

EFRAG considered the comments received from constituents and maintained its overall initial positions regarding the IASB’s proposal. The details of the comments and EFRAG’s assessment are provided in the following section.

Detailed analysis of issues, comments received, and changes made to EFRAG’s final comment letter

EFRAG’s tentative views expressed in the draft comment letter and constituents’ comments

[Proposed] EFRAG’s response to constituents’ comments

General comments and Cover Letter

EFRAG’s tentative position

EFRAG welcomed the IASB’s efforts to clarify the requirements of IAS 37 regarding the assessment of whether, in a contract, the unavoidable costs of meeting the obligations under the contract exceed the economic benefits expected to be received under it.

However, EFRAG encouraged the IASB to further discuss the potential impact of the proposed amendments on contracts in the scope of the IAS 37 onerous assessment but not previously in the scope of IAS 11 Construction Contracts.

Constituents’ comments

Six respondents agreed with EFRAG’s general comments.

Two respondents agreed with EFRAG’s initial position regarding the clarifications, however, they did not support the need to undertake further assessment of the expected impact of the proposals. They advised that, in their jurisdictions, they were not aware of any issues that suggested that the extended scope will give rise to significant adverse implications.

[Proposed] EFRAG final position

EFRAG observed that there was strong support from respondents in support of its tentative position. EFRAG therefore decided to retain its initial general position.

EFRAG’s tentative views expressed in the draft comment letter and constituents’ comments

Cost of fulfilling a contract

Proposals in the ED

The IASB proposed to specify 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).

EFRAG’s tentative position

EFRAG supported specifying 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.

However, EFRAG encouraged the IASB to further assess the expected impact of the proposals on contracts in the scope of the IAS 37 onerous assessment but not previously in the scope of IAS 11, and further discuss the types of directly-related cost that would apply to non-revenue contracts and why such an approach is more relevant for these contracts.

Constituents’ comments

All respondents agreed that the cost of fulfilling the contract comprises the costs that relate directly to the contract.

Three respondents explicitly agreed with EFRAG that it is necessary to assess the potential impact of the proposed amendments for all contracts that fall within the scope of IAS 37. Two constituents, however, took a different position and, did not expect that in their jurisdictions, the proposals would lead to significant changes in the accounting practice. Therefore, they disagreed with EFRAG and commented that no further assessment of the expected impact of proposals is needed. Other constituents agreed with EFRAG’s general comment in the Cover Letter

[Proposed] EFRAG’s response to constituents’ comments

[Proposed] EFRAG final position

EFRAG observed that there was strong support from respondents for its tentative position.

EFRAG observed also that the disagreement was based on lack of expectations for the proposals to lead to significant changes in the accounting practice in their jurisdictions. However, the majority of constituents supported EFRAG on this issue.

EFRAG therefore retained its initial position.

EFRAG’s tentative views expressed in the draft comment letter and constituents’ comments

that there is a need to further investigate the potential impact of the proposals on contracts other than those previously in the scope of IAS 11.

One respondent commented that the difference between the directly related cost approach and the incremental cost approach is not explained sufficiently clear by the IASB.

[Proposed] EFRAG’s response to constituents’ comments

EFRAG’s tentative views expressed in the draft comment letter and constituents’ comments

Examples of costs that do, and do not, relate directly to a contract

Proposals in the ED

The IASB proposed to include the following examples of costs that relate directly to the contract:

- a) direct labour;
- b) direct materials;
- c) allocations of costs that relate directly to the contract or to contract activities such as costs of contract management and supervision, insurance and depreciation of tools, and equipment and right-of-use assets used in fulfilling the contract;
- d) costs explicitly chargeable to the counterparty under the contract; and
- e) other costs incurred only because an entity entered into the contract.

The ED also proposed to explain that general and administrative costs do not relate directly to a contract unless they are explicitly chargeable to the counterparty under the contract.

EFRAG’s tentative position

EFRAG supported the IASB’s proposal to include the examples of the costs that relate directly to a contract.

However, EFRAG also noted that the notion of ‘direct costs’ and ‘directly attributable costs’ differs in IFRS Standards and suggested that the IASB should, in the longer term, further assess that guidance across IFRS

[Proposed] EFRAG’s response to constituents’ comments

[Proposed] EFRAG final position

EFRAG observed that majority of respondents supported further clarifications of the examples in the ED of costs that directly relate to a contract.

EFRAG therefore retained its initial position.

EFRAG’s tentative views expressed in the draft comment letter and constituents’ comments

[Proposed] EFRAG’s response to constituents’ comments

Standards whether the differences in terminology and guidance are justified in circumstances and cause any application difficulties.

Constituents’ comments

Scope

Four respondents proposed adding the examples related to contracts, other than previously in the scope of IAS 11, and provided the following type of contracts:

- a) purchase contracts;
- b) non-revenue contracts.

One of those respondents suggested that the IASB should be requested to provide additional examples.

Another two respondents commented that the examples provided need further clarification, such as by removing redundancies.

One respondent disagreed with EFRAG’s initial position and considered that the list of examples is complete and correctly illustrates the topic.

Other respondents did not express views on the scope.

Definition of directly attributable to contract

Three respondents agreed with EFRAG that the notion of costs directly attributable to contracts should be reviewed over the longer term in order to align it throughout IFRS Standards. Other respondents did not provide their views.

EFRAG’s tentative views expressed in the draft comment letter and constituents’ comments

Sequence of application of IFRS Standards

EFRAG’s tentative position

EFRAG noted that IAS 36 requirements do not apply to all assets used or recognised by entities when fulfilling contract obligations. This includes, for example, inventory which is recognised and measured in accordance with IAS 2, or contract assets, which are tested for impairment in accordance with IFRS 15. Consequently, applying only the requirements of IAS 36, may lead to overstating the recognised cost.

EFRAG, therefore, recommended that the IASB consider clarifying the requirements of paragraph 69 of IAS 37 and explaining that before establishing a provision for an onerous contract, entities should remeasure the assets carried due to fulfilling the contract obligations in accordance with the appropriate IFRS Standard, and then test them for impairment, in accordance with IAS 36 or other appropriate requirements.

Constituents’ comments

One respondent agreed with EFRAG’s initial position.

One respondent agreed that the guidance in IAS 37 regarding impairment should be updated.

Other respondents did not express views.

[Proposed] EFRAG’s response to constituents’ comments

[Proposed] EFRAG final position

EFRAG observed no opposition to its comment regarding the sequence of application of IFRS Standards regarding the impairment of contract related assets.

EFRAG therefore maintained its initial position.

EFRAG’s tentative views expressed in the draft comment letter and constituents’ comments

[Proposed] EFRAG’s response to constituents’ comments

Economic benefits

Proposals in the ED

The IASB decided not to address the meaning of economic benefits referred to in paragraph 67 of IAS 37.

EFRAG’s tentative position

EFRAG acknowledged the reasoning provided by the IASB not to address the meaning of ‘economic benefits’ referred to in paragraph 67 of IAS 37. However, EFRAG considered that the assessment of ‘economic benefits’ in paragraph 67 of IAS 37 also needs a more thorough explanation.

EFRAG therefore urged the IASB to consider clarifying the notion of ‘economic benefits’ during the proposed future review of IAS 37.

Constituents’ comments

Three respondents agreed with EFRAG in proposing that the IASB clarify the concept of economic benefits.

One of those respondents considered that the IASB should also focus on the concept of economic benefits, in particular when broadening the scope to reflect other types of onerous contracts.

Other respondents did not express views.

[Proposed] EFRAG final position

EFRAG observed the support for, and no opposition to, its initial position regarding the clarification of the meaning of economic benefits, referred to in paragraph 67 of IAS 37.

EFRAG therefore maintained its initial position.

EFRAG’s tentative views expressed in the draft comment letter and constituents’ comments

Transitional provisions

Proposals in the ED

The IASB proposed to limit retrospective application of the proposed amendments.

EFRAG’s tentative position

Although EFRAG usually supports full retrospective application of IFRS Standards, in this case, EFRAG agreed with the IASB’s proposal because full retrospective application of the proposed amendments was likely to be burdensome to apply, could require the use of hindsight and the benefits of restatement were likely to be outweighed by the costs.

Constituents’ comments

One of the respondents agreed with EFRAG initial position.

However, two respondents advocated also permitting a full retrospective application as an alternative, where possible without the use of hindsight.

Other respondents did not express their views regarding the topic.

[Proposed] EFRAG’s response to constituents’ comments

[Proposed] EFRAG final position

EFRAG observed some support to its initial position.

Some respondents advocated alternatively permitting a full retrospective application of the proposals where possible without the use of hindsight. However, EFRAG observed that only in limited cases applying hindsight would not be required to apply the proposals – these are the situations where a preparer has already been applying the directly related cost approach when assessing whether a contract is onerous, or situations where the contract cost only comprises the incremental costs. EFRAG concluded that full retrospective application would be limited.

EFRAG, therefore maintained its initial view on the topic.

Appendix 1: List of respondents

Table 1: List of respondents

Name of constituent¹	Country	Type / Category
Accounting Standards Committee of Germany (ASCG)	Germany	National Standard Setter
Comissão de Normalização Contabilística (CNC)	Portugal	National Standard Setter
The Dutch Accounting Standards Board (DASB)	the Netherlands	National Standard Setter
Polish Accounting Standards Committee (PASC)	Poland	National Standard Setter
European Savings and Retail Banking Group (ESBG)	Europe	Preparer Organisation
Financial Reporting Council (FRC)	UK	National Standard Setter
Instituto de Contabilidad y Auditoría de Cuentas (ICAC)	Spain	National Standard Setter
The Swedish Enterprise Accounting Group (SEAG)	Sweden	Preparer Organisation

¹ Respondents whose comment letters were considered by the EFRAG Board before finalisation of the comment letter.

Appendix 2: Summary - respondents by country and by type

Table 2: Total respondents by country and by type

Respondent by country:		Respondent by type:	
Germany	1	National Standard Setters	6
Poland	1	Business Associations	2
Portugal	1		
Spain	1		
Sweden	1		
The Netherlands	1		
UK	1		
European organisations	1		
	8		8