

18 April 2019

International Accounting Standards Board  
30 Cannon Street  
London EC4M 6XH  
United Kingdom

Dear Sirs,

**RESPONSE TO EXPOSURE DRAFT – ONEROUS CONTRACTS – COST OF FULFILLING A CONTRACT (PROPOSED AMENDMENTS TO IAS 37) (“ED”)**

ISCA sought views from its members on the above ED through a six-week public consultation and from the ISCA Financial Reporting Committee which includes experienced technical accounting professionals from large accounting firms, preparers and other stakeholders.

We appreciate and support the Board’s intention to clarify the requirements in IAS 37 *Provisions, Contingent Liabilities and Contingent Assets* in assessing whether a contract is onerous. However, we have concerns regarding the proposed amendments which we have set out below.

Question 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?

Under IAS 11 *Construction Contracts*, expected contract losses are identified by reference to total contract costs and explicit guidance is provided in IAS 11 paragraphs 16 to 21 on what constitutes such contract costs. There is little diversity in practice in this respect for contracts that are within the scope of IAS 11.

With the withdrawal of IAS 11 and the introduction of IFRS 15 *Revenue from Contracts with Customers* which does not provide specific guidance on loss-making construction contracts, the proposed amendments to IAS 37 would serve to clarify that largely similar requirements would apply to those loss-making contracts that were formerly within the scope of IAS 11.

However, we note that the IASB has not limited the proposed amendments to be applicable to construction contracts, or even contracts within the scope of IFRS 15. Instead, all contracts within the scope of IAS 37 would be covered. This, in our view, would be a significant change from current market practice for most companies that could even adversely impact companies' decision making.

*Significant change from current market practice*

Paragraphs 18 and 63 of IAS 37 explicitly states that “no provision is recognised for costs that need to be incurred to operate in the future” and “provisions shall not be recognised for future operating losses”. Paragraph 64 of IAS 37 explains that future operating losses do not meet the definition of a liability.

In view of the above requirements in IAS 37, a company typically considers only the incremental costs of fulfilling a contract (as opposed to consideration of all directly-related costs) when assessing whether a contract is onerous under IAS 37. Rationale being that costs other than the incremental costs of fulfilling a contract are essentially “normal operating costs of the business”, which are incurred regardless of whether a company enters into a contract or not. Accordingly, any provision for onerous contracts which takes into account such costs (as required under the proposed amendments) would effectively be a provision for future operating losses.

To illustrate the above:

A company employs 10 employees and staff costs amount to \$200K per staff per annum. Due to business downturn, 8 employees are idle.

Subsequently, the company obtains a 2-year non-cancellable contract with a contract sum of \$1M. For this contract, 4 of the idle employees would solely work on it for the next 2 years. Accordingly, the staff costs to be incurred is \$1.6M. To fulfil this contract, the company also needs to purchase materials costing \$400K.

The expected loss arising from this contract is as follows:

	\$'K
Contract revenue	1,000
Direct material costs	(400)
Staff costs	(1,600)
	(2,000)
Expected loss	(1,000)

As seen from the above illustration, the company would be required to recognise a \$1M provision for onerous contract at the inception of the contract. The company is effectively providing for future staff costs at the inception of the contract because of the proposed amendment. This contradicts the requirements in paragraphs 18 and 63 of IAS 37.

If the company were to assess whether the contract is onerous based on the incremental costs of fulfilling the contract (i.e. \$400K), there will be no expected loss arising from the contract and no provision for onerous contract is required to be recognised.

#### *Adverse impact on companies' decision making*

The proposed amendments could also adversely impact companies' decision making.

Using the illustration above, that company would not have any incentive to enter into any contract as the company will be required to recognise a loss at the inception of the contract. This is despite that the contract would have made a positive contribution to the company when compared to the incremental costs of that contract.

Hence, we urge the Board to re-consider the proposed amendments and further assess the expected impact of the proposals on contracts that are in scope of IAS 37 but were not previously in scope of IAS 11.

#### Question 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.

As mentioned above, we urge the Board to re-consider the proposed amendments and further assess the impact of the proposals. Should the Board decide to proceed with the proposed amendments, we would like to urge the Board to consider expanding the list of examples provided in view that the proposed amendments are to be applied to all contracts within the scope of IAS 37.

We note that the current proposed examples are based on the examples in paragraphs 97-98 of IFRS 15, and hence would cover primarily revenue contracts. We would like to suggest for the Board to consider providing examples of costs to be included when assessing for other types of contracts, for instance:

- lease contracts which are short-term or of low value
- fixed price purchase contracts

We would also like to highlight that there is inconsistency in terms of how the examples are referred to in the proposed paragraph 68A of IAS 37 and paragraph 97 of IFRS 15:

- paragraph 97 in IFRS 15 reads “Costs that relate directly to a contract include any of the following...”
- proposed paragraph 68A of IAS 37 reads “Examples of costs that relate directly to a contract to provide goods or services...”

The above inconsistency may create confusion as to why the same examples are seen as “prescriptive” in IFRS 15 but are only examples in IAS 37.

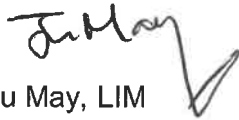
Question 3

Do you have any other comments on the proposed amendments?

Although the Board has explained in BC15 its rationale for not addressing the meaning of ‘economic benefits’ in the IAS 37 definition of an onerous contract in this ED, there exists variety in the determination of what constitutes ‘economic benefits’ in the marketplace. Hence, we would urge the IASB to provide clarification on this.

Should you require any further clarification, please feel free to contact myself or Ms Felicia Tay, Manager, TECHNICAL: Financial & Corporate Reporting, from ISCA via email at [jumay.lim@isca.org.sg](mailto:jumay.lim@isca.org.sg) or [felicia.tay@isca.org.sg](mailto:felicia.tay@isca.org.sg).

Yours faithfully,

A handwritten signature in black ink, appearing to read 'Ju May', with a large checkmark-like flourish extending from the end of the signature.

Ju May, LIM  
Deputy Director, Technical  
Institute of Singapore Chartered Accountants (ISCA)