

ASC

ACCOUNTING STANDARDS COUNCIL
SINGAPORE

18 April 2019

Mr Hans Hoogervorst
Chairman
International Accounting Standards Board
Columbus Building
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Canary Wharf
London E14 4HD
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(By online submission)

Dear Hans

RESPONSE TO EXPOSURE DRAFT ON ONEROUS CONTRACTS – COST OF FULFILLING A CONTRACT (PROPOSED AMENDMENTS TO IAS 37)

The Singapore Accounting Standards Council appreciates the opportunity to comment on the Exposure Draft on *Onerous Contracts – Cost of Fulfilling a Contract* (Proposed amendments to IAS 37) (the ED) issued by the International Accounting Standards Board (the IASB or the Board) in December 2018.

We can accept the IASB's rationale for proposing narrow-scope amendments to IAS 37 *Provisions, Contingent Liabilities and Contingent Assets* to reduce diversity in the assessment of the cost of fulfilling a contract, despite the IASB's project in its research pipeline to review IAS 37.

On the whole, we consider the narrow-scope proposed amendments to be justified by the clarification they provide to address an urgent issue. Although the ED does not address various existing challenges in applying the onerous contract requirements in IAS 37, we recognise that the ED is intended to address a specific but urgent issue that has resulted from the adoption of IFRS 15 *Revenue from Contracts with Customers*. Moreover, we have not identified significant issues that would arise from the ED, beyond those already existed under the current requirements.

Nevertheless, the IASB should consider providing the principles that an entity applies in determining directly related costs for contracts within the scope of IAS 37. The principles will provide more robust and useful guidance in comparison with examples of directly related costs for particular contracts, which may not be intuitive for other contracts within the scope of IAS 37.

Our comments on the specific questions in the ED are as follows:

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?

We agree with the IASB's proposed amendments and rationale as described in the Basis for Conclusions on the ED.

In particular, we welcome the benefits of reduced practice diversity for onerous contracts that have always been within the scope of IAS 37 and improved consistency for all onerous contracts within the scope of IAS 37.

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.

We do not object to the IASB's proposed examples, given that the ED seeks to respond to a specific request for clarification in respect of contracts that are within the scope of IFRS 15.

Nevertheless, the IASB should consider providing the principles that an entity applies in determining directly related costs for any contract within the scope of IAS 37, rather than examples of directly related costs for particular contracts within the scope of IAS 37.

While it is intuitive to align the cost of fulfilling those particular contracts between IAS 37 and IFRS 15, it may be less straightforward to determine the cost of fulfilling other contracts within the scope of IAS 37 such as purchase contracts. In practice, the cost of fulfilling a purchase contract appears to take into consideration how the purchased items will contribute to the entity's future cash flows. For example, an entity may conclude that a purchase contract for raw materials is not an onerous contract if the finished goods are profitable. Therefore, it is unclear whether and how paragraph BC26 of the Basis for Conclusions on the ED can be applied to a purchase contract, perhaps by aligning the requirements between the

cost of fulfilling the contract under IAS 37 and the measurement of non-monetary assets that will subsequently apply to the purchased items after the contract has been fulfilled.

Besides, the principles may avoid some of the pitfalls of using examples as the primary guidance. For example:

- (a) Confusion may arise from the different guidance on directly related costs in the proposed examples and the other IFRS Standards, such as IAS 2 *Inventories* which describes fixed and variable production overheads as indirect costs of production.
- (b) Questions may be raised about whether directly related costs ought to include particular costs that are not specified in the proposed examples, such as borrowing costs.

Question 3

Do you have any other comments on the proposed amendments?

In practice, there are various challenges in applying the onerous contract requirements in IAS 37. For example:

- (a) Clarification of the term ‘economic benefits’ – a term used in various IFRS Standards. For example, there are questions about whether the term should include indirect economic benefits, or how economic benefits should be determined if the contract does not generate cash inflows largely independent from other assets of the entity.
- (b) Clarification of whether there should be alignment of requirements between the identification of onerous contracts and the measurement of onerous contract provisions. For example, IAS 37 requires provisions to be measured based on the best estimate of the expenditure required to settle the present obligation, which implies different measurement outcomes depending on the manner in which the entity would exit from the contract. In contrast, onerous contracts are determined based on the least net cost of exiting from the contract, which disregards the intended manner in which an entity would exit from the contract.

While these challenges cannot be adequately addressed within the scope of the ED, they ought to be considered by the IASB in determining the scope of its research project on IAS 37.

We hope that our comments will contribute to the IASB’s deliberation on the ED. Should you require any further clarification, please contact our project manager Nicole Cai at Nicole_Cai@asc.gov.sg.

Yours faithfully

Suat Cheng Goh
Technical Director
Singapore Accounting Standards Council