

April 15, 2019

Submitted electronically via www.ifrs.org

International Accounting Standards Board
Columbus Building
7 Westferry Circus, Canary Wharf
London E14 4HD
United Kingdom

Dear Sirs:

Re: Onerous Contracts - Cost of Fulfilling a Contract (ED/2018/2)

This letter is the response of the [Canadian Accounting Standards Board](http://www.frascanada.ca) (AcSB) to the International Accounting Standards Board's (IASB) Exposure Draft, "Onerous Contracts- Cost of Fulfilling a Contract" (Proposed amendments to IAS 37)", issued in December 2018.

Our process

As part of our due process for these proposals, we consulted with our [IFRS® Discussion Group](#) and took into account the results of this discussion when developing this letter.

Our views

We commend the IASB's work to clarify which costs to include in determining the cost of fulfilling a contract to reduce diversity in practice created by the removal of IAS 11 *Construction Contracts*.

We agree that paragraph 68 of IAS 37 *Provisions, Contingent Liabilities and Contingent Assets* should specify that the cost of fulfilling a contract comprises the costs that relate directly to the contract. However, we are concerned with the IASB's decision not to address the meaning of economic benefits as part of this onerous contract project. We are of the view that both the economic benefits and the cost of fulfilling a contract are important elements in determining whether a contract is onerous and should be addressed together. For example, we think the current proposals do not address the situation in which an

entity might enter into a contract to fill idle capacity. Bringing the concept of economic benefits into determining whether a contract is onerous or not would acknowledge this situation as the entity might be better off to take on the contract as it would absorb more of the overhead costs.

On a related note, we also think the amendments are unclear if the directly related cost approach would only be used to assess whether the contract is onerous or if the approach would be used for measurement purposes as well.

As such, we suggest that the IASB increase the scope of this project to address economic benefits. We understand that this project is narrow in scope but without the inclusion of economic benefits, we think the resulting information would not be complete or helpful to users. If it is not feasible to include economic benefits, we recommend that the IASB initiate a separate narrow scope project on economic benefits in order to resolve this issue as soon as possible.

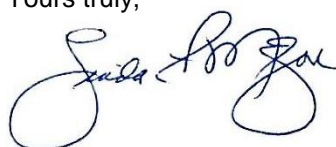
Finally, while we support the modified retrospective approach, we disagree with the IASB's decision not to allow the option to apply full retrospective application in accordance with IAS 8 *Accounting Policies, Changes in Accounting Estimates and Errors*. We recommend allowing the use of full retrospective application for entities as long as those entities have the information available to do so without the use of hindsight.

Our response to your questions

The Appendix to this letter responds to the questions posted in the Exposure Draft and expands on the points raised above.

We would be pleased to elaborate on our comments in more detail if you require. If so, please contact me or, alternatively Katharine Christopoulos, Senior Principal, Accounting Standards (+1 416 204-3270 or email kchristopoulos@acsbcanada.ca), or Sean Wang, Principal, Accounting Standards (+1 416 204-2969 or email swang@acsbcanada.ca).

Yours truly,



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About the Canadian Accounting Standards Board

We are an independent body with the legal authority to establish accounting standards for use by all Canadian publicly accountable enterprises, private enterprises, not-for-profit organizations and pension plans in the private sector. We are comprised of a full-time Chair and volunteer members from a variety of backgrounds, including financial statement users, preparers, auditors and academics; a full-time staff complement supports our work.

Our standards

We have adopted IFRS[®] Standards as issued by the IASB for publicly accountable enterprises. Canadian securities legislation permits the use of U.S. GAAP in place of IFRS Standards in certain circumstances. We support a shared goal among global standard setters of high-quality accounting standards that result in comparable financial reporting outcomes regardless of the GAAP framework applied.

We developed separate sets of accounting standards for private enterprises, not-for-profit organizations and pension plans. Pension plans are required to use the applicable set of standards. Private enterprises and not-for-profit organizations can elect to apply either the set of standards developed for them, or IFRS Standards as applied by publicly accountable enterprises.

Our role vis-à-vis IFRS Standards

Our responsibility to establish Canadian GAAP necessitates an endorsement process for IFRS Standards. We evaluate and rely on the integrity of the IASB's due process as a whole, and monitor its application in practice. In addition, we perform our own due process activities for each new or amended IFRS Standard to ensure that the standard is appropriate for application in Canada. We reach out to Canadians on the IASB's proposals to understand and consider their views before deciding whether to endorse a final IFRS Standard. A final standard is available for use in Canada only after we have endorsed it as Canadian GAAP.

APPENDIX

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?

1. We 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 for the reasons provided in paragraphs BC16-BC28 of the Basis for Conclusions. However, without including the concept of economic benefits, undesirable outcomes might arise as the proposed amendment only addresses part of the issue. We elaborate on economic benefits in our response to Question 3.

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.

2. We agree with the items listed in paragraphs 68A and 68B of the Exposure Draft. However, we think the paragraphs 68A and 68B of the Exposure Draft should be expanded to include additional examples to reduce ambiguity and diversity in practice. Specifically, we make the following recommendations:
 - a. Provide clarity on the treatment of costs from abnormal wastages. We note that costs from abnormal wastages were not addressed in paragraphs 68A or 68B of the Exposure Draft. However, they are specifically addressed in both IFRS 15 *Revenue from Contracts with Customers* and IAS 2 *Inventories*. Paragraph 98 of IFRS 15, which paragraphs 68B is adapted from, explicitly states that "costs of wasted materials, labour or other resources to fulfil the contract that were not reflected in the price of the contract" shall be expensed when incurred. Paragraph 16(a) of IAS 2 also specifically excludes "abnormal amounts of wasted materials, labor or other production costs" from the cost of inventories. These costs are expensed as incurred. Costs from abnormal wastages can

relate directly to the contract and could be included in the measurement of onerous contracts so the IASB should consider providing clarity in this regard.

- b. Expand the example for direct labour to include all forms of compensation paid to the employees. "Salaries and wages of employees" is currently used as an example of direct labour in the paragraph 68A(a) of the Exposure Draft. We think this example should be broadened to include all forms of compensation paid to the employees. This includes cost of employee benefits (as defined in IAS 19 *Employee Benefits*) and cost from share-based payment arrangements (as defined in IFRS 2 *Share-based Payment*). We think this change will also improve the alignment with IAS 16 *Property, Plant and Equipment* and IAS 38 *Intangible Assets*. The term "cost of employee benefits" (as defined in IAS 19 *Employee Benefits*) is used as an example of directly attributable costs in paragraphs 17(a) of IAS 16 and 28(a) of IAS 38.

Question 3

Do you have any other comments on the proposed amendments?
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3. We are concerned with the IASB's decision not to address economic benefits as part of this onerous contract project. We think the IASB should clarify whether the economic benefits should include other expected indirect benefits under the contract. Addressing only the cost element can result in an overall beneficial contract becoming onerous. This is often the case when an entity enters into a new contract to utilize idle capacity that is beneficial to the entity because it absorbs more of the overhead costs. However, if these economic benefits are not captured, the additional allocated cost will make this contract onerous. This outcome would not provide useful information to users of financial statements.
4. On a related note, we also think the amendments are unclear if the directly related cost approach would only be used to assess whether the contract is onerous or if the approach would be used for measurement purposes as well. For instance, the introduction section of the Exposure Draft states that "the amendments specify the costs an entity includes in determining the 'cost of fulfilling' a contract for the purpose of assessing whether a contract is onerous". (emphasis added). This seems to be inconsistent with wordings in paragraph BC14 in the Basis for Conclusions which states "the entity could measure an onerous contract provision by including the same costs as it used to identify the contract as onerous". (emphasis added). If the intent of the IASB is to use the same costs in assessing and measuring an onerous contract, the need for guidance on economic benefits is even more important.

5. Therefore, we suggest that the IASB increase the scope of this project to address economic benefits. We understand this will cause a delay in issuing the guidance the IASB considers urgent. However, we are of the view that both the economic benefits and the cost of fulfilling a contract are important elements in determining whether a contract is onerous and should be addressed together. If this is not feasible, we recommend that the IASB initiate a separate narrow scope project in order to resolve this issue as soon as possible.

6. We disagree with the IASB's decision not to provide the option to apply the retroactive application in accordance with IAS 8 *Accounting Policies, Changes in Accounting Estimates and Errors* ("full retrospective application") in paragraph 94A of the Exposure Draft. We understand the IASB's concern that the full retrospective could be costly for some financial statement preparers to comply. However, financial statement preparers should be making the judgement of the costs based on their own circumstances. During our outreach, some financial statement users were of the view that the comparability between financial statement periods is more valuable than the comparability across entities related to onerous contracts. These stakeholders think the loss of comparability across entities described in paragraph BC36 of the Basis for Conclusions is not a compelling reason to remove the option for full retrospective application. As such, we recommend allowing the use of the retrospective option for entities as long as those entities have the information available to do so without the use of hindsight.