

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.

Onerous Contracts

Cost of Fulfilling a Contract, Amendments to IAS 37 *Provisions, Contingent Liabilities and Contingent Assets*

Cover Note

Objective

- 1 The objective of the session is to discuss and recommend the EFRAG Board to approve EFRAG's Draft Endorsement Advice on the recently published EFRAG's amendments to IAS 37 *Provisions, Contingent Liabilities and Contingent Assets – Cost of Fulfilling a Contract* (the Amendments).

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 not only the incremental costs of the contract but also the allocation of costs that **relate directly to the contract**. The above clarification is consistent with the guidance on contract costs in IFRS 15.
- 5 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). EFRAG commented on the ED on 24 April 2019 where EFRAG welcomed the IASB's efforts to clarify the requirements in IAS 37. EFRAG final comment letter can be found at the following [link](#).
- 6 In response to the ED, EFRAG considered that the proposals not sufficiently addressed contracts in the scope of the IAS 37 onerous contract assessment but previously not in the scope of IAS 11. Moreover, EFRAG noted that the scope of the IAS 37 onerous test also includes purchase contracts. Therefore, EFRAG suggested that the IASB also consider examples of specific types of costs that should be included when assessing purchase contracts.

The Amendments

- 7 The IASB, following its discussion on the feedback received, decided to finalise the Amendments with some editorial modifications and extended explanations in the Basis for Conclusions. Accordingly, on 14 May, the IASB published the Amendments. The text of the Amendments are available [here](#).

Onerous Contracts Cost of Fulfilling a Contract - Cover Note

- 8 The following table evaluates how the Amendments address the issues included in the Final Comment Letter:

Issue raised	How addressed?
Assessment of impact on contracts previously not in the scope of IAS 11	The IASB considered the impact of the Amendments on other types of contracts. For instance, the IASB discussed that IAS 2 requirements are broadly consistent with the requirements of IAS 37 and that a manufacturing entity that enters into contracts to supply inventory is likely to need information about both the incremental costs and allocation of production overheads to make future pricing decisions. Therefore, that entity would likely already have the information it needs to estimate and allocate the costs that will relate directly to contracts into which it has entered
Purchase contracts	The IASB has decided not to consider the broader scope of the Amendments and explained in BC19 that by doing so would have prolonged the project, delaying the issue of amendments regarded as urgent.
Order of application of impairment and recognition of the provision	The IASB clarified paragraph 69 of IAS 37 to explain that before a provision for an onerous contract is established, an entity should recognise any impairment loss that has occurred on assets used in fulfilling the contract.

Transitional provisions

- 9 The IASB decided that the Amendments shall be applied only to contracts for which an entity has not yet fulfilled all its obligations at the beginning of the annual reporting period in which it first applies the Amendments i.e. the date of initial application. The entity shall not restate comparative information. Instead, the entity shall recognise the cumulative effect of initially applying the Amendments as an adjustment to the opening balance of retained earnings or other component of equity, as appropriate, at the date of initial application.
- 10 The Amendments shall be applied for annual periods beginning on or after 1 January 2022, with earlier application permitted. If entities apply the Amendments earlier, they shall disclose that fact.

Questions for EFRAG TEG members

- 11 Do you have comments on the drafting of proposed EFRAG Endorsement Advice?
- 12 Do you recommend the draft to the EFRAG Board for approval?

Agenda Papers

- 13 In addition to this cover note, Agenda Paper 05-02 – EFRAG Draft Endorsement Advice, has been uploaded for the discussion.