Agenda request – accounting for training costs which are necessary to fulfil, and are specific to, a contract

We have identified divergent views about the appropriate accounting requirements for certain employee training costs. These have arisen principally following the adoption of IFRS 15 *Revenue from Contracts with Customers* and, in cases we have dealt with, it can have a material effect on the related financial statements.

We have set out a description of a typical fact pattern, together with the two principal views that we have seen in practice, in the attached Appendix.

Appendix

Suggested agenda item – accounting for training costs which are necessary to fulfil, and are specific to, a contract

We have identified divergent views about and practices for the appropriate accounting treatment for certain training costs associated with employees, in connection with a contract which falls within the scope of IFRS 15 *Revenue from Contracts with Customers*. We are seeking clarification of the issue from the Committee.

Background

Entity A enters into a contract that is within the scope of IFRS 15 to supply outsourced services to Entity B (for example, a call centre where Entity A's staff take calls from Entity B's customers and assist them online with electronic products that they have purchased from Entity B). In order for Entity A to be able to provide the services to Entity B, Entity A must incur training costs for its own employees in order that they are able to utilise Entity B's equipment and understand its processes.

The requirement for Entity A to provide training to its employees does not meet the definition of a performance obligation in IFRS 15. This is because Entity A's act of training its own employees does not transfer a distinct good or service to the customer, Entity B. Instead, the employee training enables Entity A to put itself in a position to be able to provide the outsourced service that it has promised to Entity B.

The training requirements are set out in a specific section of the contract between Entity A and Entity B, with a specified recharge which will cover the training costs. The recharge covers the number of Entity A's employees who require training at the start of the contract, and the training of new employees if Entity B's operations expand and additional staff are required. Costs associated with training replacement employees (for example, because some of the employees leave Entity A's employment) are not covered and must be paid by Entity A.

Issue

Should the training costs incurred which relate to the fulfilment of Entity A's contract with its customer, Entity B, be recognised as a contract asset (IFRS 15.95)?

View 1

Training costs should not be capitalised as a cost to fulfil a contract, regardless of whether they are explicitly rechargeable in Entity A's contract with its customer.

IFRS 15.95 requires that:

> 'If the costs incurred in fulfilling a contract with a customer are not within the scope of another Standard (for example, IAS 2 *Inventories*, IAS 16 *Property, Plant and Equipment* or IAS 38 *Intangible Assets*), an entity shall recognise an asset from the costs incurred to fulfil a contract only if those costs meet all of the following criteria….'

Therefore, IFRS 15.95 first requires that another applicable IFRS does not address the accounting for the costs incurred prior to the criteria in paragraph 95, and guidance in paragraphs 97 and 98, being considered. IFRS 15.96 is clear that cost that are within the scope of another Standard are accounted for in accordance with that other standard. In this context, training costs are specifically addressed in IAS 38. IAS 38.69 requires that (extract):

> 'In some cases, expenditure is incurred to provide future economic benefits to an entity, but no intangible asset or other asset is acquired or created that can be recognised. … Other examples of expenditure that are recognised as an expense when it is incurred include:
>
> a) …
> b) Expenditure on training activities
> c) …
> d) …'

Consequently, training costs that are incurred in respect of a contract with a customer which is within the scope of IFRS 15 cannot be recognised as an asset, and must be expensed as incurred. This is consistent with the IASB's discussion in the Basis for Conclusions to IFRS 15 at paragraph BC307 (extract):

> 'Because the boards decided not to reconsider all cost requirements comprehensively, paragraphs 91-98 of IFRS 15 specify the accounting for contract costs which are not within the scope of other Standards. Consequently, if the other Standards preclude the recognition of any asset arising from a particular cost, an asset cannot be recognised under IFRS 15…..'

The requirement in IAS 38 to expense all training costs as incurred was included in the original version of that standard which was issued by the International Accounting Standards Committee (IASC) in 1998 (and subsequently adopted by the IASB). As part of the IASC's Basis for Conclusions, it noted that (BCZ46):

> 'IAS 38 also clarifies that expenditure on research, training, advertising and start-up activities will not result in the creation of an intangible asset that can be recognised in the financial statements. Whilst some view these requirements and guidance as being too restrictive and arbitrary, they are based on the IASC's interpretation of the recognition criteria in IAS 38…'

A prohibition on capitalising employee training costs is consistent with the requirement that an asset must be controlled. Since an employer does not control its employees, it follows that training costs that enhance the knowledge and performance of employees cannot be capitalised. This is also consistent with the requirements of IFRS 3 *Business Combinations*, which prohibits the recognition of an asset for an acquired assembled workforce because it is not an identifiable asset (IFRS 3.B37).

Proponents of view 1 consider that the scope exclusion in IAS 38.3(i) referred to in view 2 does not mean that there is a scope exclusion from IAS 38 for all costs incurred in fulfilling a contract with a customer. This is because an exclusion from the requirements of IAS 38.3 for all such costs would result in all intangible assets arising from a contract within the scope of IFRS 15 being excluded from the scope of IAS 38, which would result in the explicit reference to the scope of IAS 38 in IFRS 15.95 being meaningless.

View 2

The training costs in the fact pattern set out above meet all of the criteria in IFRS 15.95 and should be capitalised.

In the fact pattern, the training costs:

- relate specifically to a contract that Entity A can identify (IFRS 15.95(a));
- enhance the resources of Entity A that will be used in satisfying performance obligations in the future (IFRS 15.95(b)); and
- are expected to be recovered (IFRS 15.95(c)).

A key difference between IFRS 15.95 and the criteria in IAS 38 is that, under IFRS 15.95, the entity does not need to control the resource. It is not necessary to demonstrate that the employees are controlled by Entity A and, instead, it is sufficient that Entity A's resources (the employees) have been enhanced by the training.

Proponents of view 2 note that IAS 38.3 requires that:

> 'If another Standard prescribes the accounting for a specific type of intangible asset, an entity applies that Standard instead of this Standard. For example, this Standard does not apply to:
>
> a) …
> b) …
> c) …
> d) …
> e) …
> f) …
> g) …
> h) …
> i) assets arising from contracts with customers that are recognised in accordance with IFRS 15 *Revenue from Contracts with Customers*.'

Consequently, they consider that IAS 38 does not apply to intangible assets that arise from contracts with customers, and instead the relevant criteria are those set out in IFRS 15.95. This is consistent with IFRS 15.97(d), which includes the following as costs that relate directly to a contract:

> d) costs that are explicitly chargeable to the customer under the contract

Proponents of view 2 consider that because Entity A's training costs are explicitly recharged to the customer, this further supports the view that it is appropriate to capitalise the training costs incurred by Entity A.

Reasons for the Interpretations Committee to address the issue

The question of whether training costs can be capitalised in circumstances such as those set out above is arising with increasing frequency, following the adoption by entities of IFRS 15. When the issue is relevant, the effect on entities' financial statements can be significant.

We believe that the issue is sufficiently narrow that it would be straightforward to provide clarity, if necessary, through a minor amendment to existing IFRS requirements. The issue is not related to a Board project that is expected to be completed in the near future.

For these reasons, we believe that this issue meets the criteria for the Interpretations Committee to address it.