STAFF PAPER

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IFRS® Interpretations Committee meeting

Project	Training Costs to Fulfil a Contract (IFRS 15)		
Paper topic	Initial Consideration		
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Introduction

1. The IFRS Interpretations Committee (Committee) received a submission about training costs incurred to fulfil a contract. Specifically, the submitter asked whether the training costs meet the criteria in paragraph 95 of IFRS 15 *Revenue from Contracts with Customers* for an entity to recognise those costs as an asset.

2. The objective of this paper is to:

   (a) provide the Committee with a summary of the matter;

   (b) present our research and analysis; and

   (c) ask the Committee whether it agrees with our recommendation not to add the matter to its standard-setting agenda.

Structure of the paper

3. This paper includes the following:

   (a) background information (paragraphs 5–7);

   (b) outreach (paragraphs 8–15);

   (c) staff analysis (paragraphs 16–38); and

   (d) staff recommendation (paragraphs 39–40).

4. There are two appendices to this paper:

   (a) Appendix A—proposed wording of the tentative agenda decision; and

   (b) Appendix B—submission.

Background information

5. The submission outlines the following fact pattern:

   (a) Entity A enters into a contract with a customer, Entity B, that is within the scope of IFRS 15. The contract is for the supply of outsourced services.

   (b) to be able to provide the services to Entity B, Entity A incurs training costs for its employees so that they understand Entity B's equipment and processes. Applying IFRS 15, Entity A does not identify the training as a performance obligation.

   (c) the contract permits Entity A to recharge to Entity B the costs of training (i) Entity A's employees at the beginning of the contract, and (ii) new employees that Entity A hires as a result of any expansion of Entity B's operations. Entity A is unable to recharge costs associated with training replacement employees (ie new employees of Entity A recruited to replace those that leave Entity A's employment).

6. The submission provides, as an example, a call centre where Entity A's employees take calls from Entity B's customers, and provide them with online assistance for electronic products purchased from Entity B.

7. The submitter asks whether, in the fact pattern described in the submission, Entity A recognises an asset for the training costs incurred to fulfil a contract with a customer (Entity B) applying paragraph 95 of IFRS 15.

Outreach

8. We sent an information request to members of the International Forum of Accounting Standard-Setters, securities regulators and large accounting firms.

9. The request asked those participating to provide information based on their experience about:

   (a) the prevalence of the fact pattern; and

   (b) whether entities typically recognise an asset for the training costs incurred and, if so, which IFRS requirements those entities apply.

10. We received twelve responses—six from large accounting firms, five from national standard-setters and one from an organisation representing groups of securities regulators. The views received represent informal opinions, rather than formal views of those responding.

Prevalence

11. Some respondents said the fact pattern described in the submission (or similar fact patterns) is common in industries that provide outsourcing or long-term services—for example, outsourced IT, infrastructure management, facilities management, maintenance, call centres and public transportation services.

12. One respondent said the fact pattern is common in Australia. Another respondent noted the existence of the fact pattern in Australia and the UK. Others said it is not common in Canada, Hong Kong, Israel and Japan.

Accounting treatment applied

13. Most respondents said entities generally do not recognise training costs as an asset. This is because:

   (a) applying paragraph 95 of IFRS 15, entities first determine whether costs incurred in fulfilling a contract are within the scope of another Standard. IAS 38 *Intangible Assets* provides requirements on training costs; and

   (b) employees are not a resource controlled by the entity. Therefore, training costs do not meet the criteria in paragraph 95 of IFRS 15 to be recognised as an asset.

14. Three respondents reported mixed practice—some entities recognise training costs as an asset applying IFRS 15 and some recognise them as an expense. Those respondents said entities recognising training costs as an asset support that accounting as follows:

    (a) paragraph 97(d) of IFRS 15 includes as a cost that relates directly to a contract 'costs that are explicitly chargeable to the customer under the contract'. In the fact pattern described in the submission, most training costs are explicitly rechargeable to Entity B; and

    (b) to recognise an asset, paragraph 95 of IFRS 15 does not explicitly require the entity to control a resource.

15. One respondent noted that IFRS Standards do not define training activities and, thus, an entity may need to apply judgement to determine whether a particular activity is 'training' within the scope of IAS 38.

Staff analysis

Which IFRS Standard applies?

16. Paragraphs 95-96 of IFRS 15 state:

> 95 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:
>
> (a) the costs relate directly to a contract or to an anticipated contract that the entity can specifically identify (for example, costs relating to services to be provided under renewal of an existing contract or costs of designing an asset to be transferred under a specific contract that has not yet been approved);

> (b) the costs generate or enhance resources of the entity that will be used in satisfying (or in continuing to satisfy) performance obligations in the future; and
>
> (c) the costs are expected to be recovered.
>
> 96 For costs incurred in fulfilling a contract with a customer that are within the scope of another Standard, an entity shall account for those costs in accordance with those other Standards.

17. Paragraphs BC306–BC307 of IFRS 15 explain that the Board decided not to reconsider cost requirements in other Standards when developing IFRS 15. In particular, paragraph BC307 states:

> Because the boards decided not to reconsider all cost requirements comprehensively, paragraphs 91-98 of IFRS 15 specify the accounting for contract costs that 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 then be recognised applying IFRS 15 (for example, in IFRS, initial operating losses, such as those incurred while demand for an item builds, will continue to be accounted for in accordance with paragraph 20(b) of IAS 16 and…).

18. An entity therefore considers the requirements in other Standards before applying the criteria in paragraph 95 of IFRS 15.

19. Paragraph 5 of IAS 38 states:

> This Standard applies to, among other things, expenditure on advertising, training, start-up, research and development activities. …

20. Consequently, we conclude that, in the fact pattern described in the submission, the entity applies IAS 38 in accounting for training costs incurred to fulfil the contract with the customer.

Application of IAS 38

21. Paragraph 69(b) of IAS 38 lists 'expenditure on training activities' as an example of expenditure that an entity recognises as an expense when incurred.

22. Paragraph 15 of IAS 38 explains why this is the case. It states:

> An entity may have a team of skilled staff and may be able to identify incremental staff skills leading to future economic benefits from training. The entity may also expect that the staff will continue to make their skills available to the entity. However, an entity usually has insufficient control over the expected future economic benefits arising from a team of skilled staff and from training for these items to meet the definition of an intangible asset. For a similar reason, specific management or technical talent is unlikely to meet the definition of an intangible asset, unless it is protected by legal rights to use it and to obtain the future economic benefits expected from it, and it also meets the other parts of the definition.

23. IAS 38 requires an entity to recognise training costs as an expense because an entity typically has insufficient control over the expected future economic benefits arising from trained employees to meet the definition of an asset. IAS 38 defines an asset as:

> …a resource: (a) controlled by an entity as a result of past events; and (b) from which future economic benefits are expected to flow to the entity.

24. The definition of an asset in IAS 38 is the same as the definition in the *Conceptual Framework for Financial Reporting* (pre-2018). The existence of control within the definition of an asset was retained in the 2018 *Conceptual Framework for Financial Reporting*—the 2018 *Conceptual Framework* defines an asset as 'a present economic resource controlled by an entity as a result of past events'.

25. In the fact pattern described in the submission, employees of Entity A can leave Entity A's employment. Entity A does not control the expected future economic benefits arising from those employees. Therefore, applying IAS 38 Entity A recognises training costs as an expense.

Scope exclusion from IAS 38

26. The submission notes that some say IAS 38 does not apply to training costs as described in the submission. This is because paragraph 3 of IAS 38 defines the scope of IAS 38 to exclude assets recognised applying IFRS 15. It states:

> 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: …
>
> (i) assets arising from contracts with customers that are recognised in accordance with IFRS 15 *Revenue from Contracts with Customers*.

27. We do not agree. As noted earlier, paragraph 5 of IAS 38 requires an entity to apply IAS 38 to expenditure on training (see paragraph 19 of this paper).

28. In addition, we note that IFRS 15 explicitly states that an entity does not apply the criteria in paragraph 95 to costs within the scope of IAS 38. Paragraph 95 states 'if the costs incurred in fulfilling a contract with a customer are not within the scope of another Standard (for example…IAS 38…), an entity shall recognise an asset from the costs incurred to fulfil a contract only if those costs meet all of the following criteria…'. Paragraph 96 states:

> For costs incurred in fulfilling a contract with a customer that are within the scope of another Standard, an entity shall account for those costs in accordance with those other Standards.

29. Reading paragraph 3(i) of IAS 38 to say that an entity applies IFRS 15 in accounting for training costs incurred to fulfil a contract would contradict both the requirements in paragraphs 95-96 of IFRS 15 and also paragraph 5 of IAS 38.

30. Accordingly, we conclude that an entity applies IAS 38 in accounting for training costs as described in the submission.

What if an entity were to apply IFRS 15?

31. As noted above, we conclude that an entity applies IAS 38 to the training costs described in the submission based on our analysis of the requirements in IFRS 15 and IAS 38.

32. Nonetheless, for completeness we have considered the outcome if an entity were to apply the criteria in paragraph 95 of IFRS 15 to the training costs described in the submission.

33. To recognise an asset from the costs incurred to fulfil a contract, paragraph 95(b) of IFRS 15 requires the costs incurred by the entity to 'generate or enhance resources of the entity that will be used in satisfying (or in continuing to satisfy) performance obligations in the future'. In explaining the rationale for the criteria in paragraph 95, paragraph BC308 of IFRS 15 states (**emphasis** added):

> IFRS 15 clarifies that only costs that give rise to resources that will be used in satisfying performance obligations in the future and that are expected to be recovered are eligible for recognition as assets. Those requirements ensure that **only costs that meet the definition of an asset** are recognised as such and that an entity is precluded from deferring costs merely to normalise profit margins throughout a contract by allocating revenue and costs evenly over the life of the contract...

34. For the reasons described in paragraphs 19–23 of this paper, an entity generally does not control its employees and, therefore, they are not (**emphasis** added) 'resources **of the entity** that **will be used** in satisfying (or in continuing to satisfy) performance obligations in the future' as contemplated in paragraph 95(b) of IFRS 15.

35. As noted earlier in the paper, an asset is defined in the 2018 *Conceptual Framework* as 'a present economic resource controlled by the entity as a result of past events'. Paragraphs 4.19 and 4.20 of the *Conceptual Framework* explain that 'control links an economic resource to an entity…an entity controls an economic resource if it has the present ability to direct the use of the economic resource and obtain the economic benefits that may flow from it'. With respect to its employees, Entity A does not have

that present ability because the employees could decide to leave Entity A's employment.

36. Accordingly, even if an entity were to apply IFRS 15 to the training costs described in the submission, in our view the entity would not recognise those costs as an asset.

Staff conclusion

37. In the fact pattern described in the submission, we conclude that the entity accounts for the training costs incurred to fulfil the contract with Entity B applying IAS 38. It therefore recognises those costs as an expense when incurred.

Question 1 for the Committee
1. Does the Committee agree with our analysis of the application of the requirements in IFRS Standards to the fact pattern described in the submission summarised in paragraph 37 of this paper?

Should the Committee add this matter to its standard-setting agenda?

Is it necessary to add to or change IFRS Standards to improve financial reporting?[1]

38. Based on our analysis, we think the requirements in IFRS 15 and IAS 38 provide an adequate basis for an entity to determine its accounting for training costs incurred to fulfil a contract.

Staff recommendation

39. Based on our assessment of the Committee's agenda criteria in paragraphs 5.16–5.17 of the *Due Process Handbook* (discussed in paragraph 38 of this paper), we recommend that the Committee does not add this matter to its standard-setting agenda.

[1] Paragraph 5.16(b) of the *Due Process Handbook*

Instead, we recommend publishing a tentative agenda decision that outlines how an entity accounts for training costs incurred to fulfil a contract.

40. Appendix A to this paper sets out the proposed wording of the tentative agenda decision.

Questions 2 and 3 for the Committee

2. Does the Committee agree with our recommendation not to add this matter to its standard-setting agenda?
3. Does the Committee have any comments on the proposed wording of the tentative agenda decision set out in Appendix A to this paper?

Appendix A—proposed wording of the tentative agenda decision

Training Costs to Fulfil a Contract (IFRS 15 *Revenue from Contracts with Customers*)

The Committee received a request about training costs incurred to fulfil a contract. In the fact pattern described in the request:

a) an entity enters into a contract with a customer that is within the scope of IFRS 15. The contract is for the supply of outsourced services.

b) to be able to provide the services to the customer, the entity incurs training costs for its employees so that they understand the customer's equipment and processes. Applying IFRS 15, the entity does not identify the training as a performance obligation.

c) the contract permits the entity to recharge to the customer the costs of training (i) the entity's employees at the beginning of the contract, and (ii) new employees that the entity hires as a result of any expansion of the customer's operations. The entity is unable to recharge costs associated with training replacement employees (ie new employees of the entity recruited to replace those that leave the entity's employment).

The request asked whether the entity recognises the training costs as an asset or an expense when incurred.

Which IFRS Standard applies to the training costs?

Paragraph 95 of IFRS 15 requires an entity to recognise an asset from the costs incurred to fulfil a contract with a customer not within the scope of another IFRS Standard, only if those costs meet all the three criteria specified in paragraph 95. Consequently, before assessing the criteria in paragraph 95, an entity first considers whether training costs incurred to fulfil a contract are within the scope of another Standard.

Paragraph 5 of IAS 38 states that 'this Standard applies to, among other things, expenditure on advertising, training, start-up, research and development activities'. Accordingly, the Committee concluded that, in the fact pattern described in the request, the entity applies IAS 38 in accounting for the training costs incurred to fulfil the contract with the customer.

Application of IAS 38

Paragraph 69(b) of IAS 38 lists 'expenditure on training activities' as an example of expenditure that an entity recognises as an expense when incurred. Paragraph 15 of IAS 38 explains why this is the case. It states that 'an entity usually has insufficient control over the expected future economic benefits arising from a team of skilled staff and from training for these items to meet the definition of an intangible asset'.

In addition, in explaining the requirements in IFRS 15 regarding costs to fulfil a contract, paragraph BC307 of IFRS 15 states that 'if the other Standards preclude the recognition of any asset arising from a particular cost, an asset cannot then be recognised under IFRS 15'.

Accordingly, the Committee concluded that, in the fact pattern described in the request, the entity recognises as an expense when incurred the training costs to fulfil the contract with the customer.

The Committee concluded that the principles and requirements in IFRS 15 and IAS 38 provide an adequate basis for an entity to determine its accounting for training costs incurred to fulfil a contract with a customer. Consequently, the Committee [decided] not to add this matter to its standard-setting agenda.

Appendix B—submission

B1. We have reproduced the submission below, and in doing so deleted details that would identify the submitter of this request.

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:
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> a) …
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> b) …
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> c) …
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> d) …
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> e) …
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> f) …
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> g) …
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> 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.