

STAFF PAPER

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IASB Meeting

Project	Onerous Contracts—Cost of Fulfilling a Contract (Amendments to IAS 37)		
Paper topic	Effective Date and Due Process		
CONTACT(S)	Craig Smith	csmith@ifrs.org	+44 (0)20 7246 6410

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Introduction and purpose

1. In September 2019, the International Accounting Standards Board (Board) decided to proceed with finalising its proposed amendments to IAS 37 *Provisions, Contingent Liabilities and Contingent Assets* published in the Exposure Draft *Onerous Contracts—Cost of Fulfilling a Contract*. The Exposure Draft proposed to specify that when assessing whether a contract is onerous, the cost of fulfilling a contract comprises the costs that relate directly to the contract.
2. The purpose of this paper is to:
 - (a) ask the Board whether it agrees with our recommendation with respect to the effective date for the amendments to IAS 37;
 - (b) set out the steps in the [IFRS Foundation Due Process Handbook](#) that the Board has taken in developing the amendments;
 - (c) ask the Board to confirm it is satisfied that it has complied with the due process requirements; and
 - (d) ask whether any Board member intends to dissent from the issuance of the amendments.

Structure of the paper

3. This paper is structured as follows:
 - (a) Summary of the amendments (paragraphs 5–8);
 - (b) Effective date (paragraphs 9–15);
 - (c) Due process steps and permission for balloting (paragraphs 16–24):
 - (i) re-exposure;
 - (ii) intention to dissent;
 - (iii) confirmation of due process steps; and
 - (iv) proposed timetable for balloting and publication.
4. The appendix to this paper outlines the actions taken by the Board to meet the due process requirements.

Summary of the amendments

5. IAS 37 defines an onerous contract as a contract in which the unavoidable costs of meeting the obligations under the contract exceed the economic benefits expected to be received under it. IAS 37 also states that the unavoidable costs under a contract reflect the least net cost of exiting from the contract, which is the lower of the cost of fulfilling it and any compensation or penalties arising from failure to fulfil it. However, IAS 37 does not specify which costs to include in determining the cost of fulfilling a contract.
6. The Board developed proposals to clarify which costs to include. The Exposure Draft proposed adding a sentence to paragraph 68 of IAS 37 that would state the cost of fulfilling a contract comprises the costs that relate directly to the contract. The Exposure Draft also proposed to add examples of costs that relate directly to a contract to provide goods or services.
7. In September 2019, the Board decided to proceed with its proposal to clarify that the cost of fulfilling a contract comprises the costs that relate directly to the contract. Nonetheless, in response to comments received, the Board decided to replace the

examples proposed in the Exposure Draft with a clarification that the costs that relate directly to the contract consist of:

- (a) the incremental costs of fulfilling that contract, and
- (b) an allocation of costs that relate directly to fulfilling that and other contracts.

8. The Board also decided to amend paragraph 69 of IAS 37 to refer to assets that relate directly to a contract, rather than assets dedicated to a contract.

Effective date

- 9. In October 2019, the Board decided to retain the transition requirements proposed in the Exposure Draft, ie an entity would apply the amendments to contracts under which it has not yet fulfilled all its obligations at the date it first applies the amendments. Entities would not restate comparative information.
- 10. The Board did not propose an effective date but proposed that earlier application be permitted.
- 11. Paragraph 6.35 of the Due Process Handbook explains that the effective date of any amendment is set so that (a) jurisdictions have sufficient time to incorporate the new requirements into their legal systems; and (b) those applying IFRS Standards have sufficient time to prepare for the new requirements.
- 12. The Board generally allows at least 12 to 18 months between the issuance of a new Standard or amendment and its effective date.
- 13. If the Board agrees with our recommendations set out in this paper, we expect the Board to issue the amendments during the second quarter of 2020.
- 14. We think entities and jurisdictions would have sufficient time to apply and incorporate the amendments if the Board were to set an effective date of 1 January 2022—ie approximately 18 months after the end of the second quarter of 2020. Accordingly, we recommend that the Board require entities to apply the amendments for annual periods beginning on or after 1 January 2022.
- 15. The Board received no feedback on its proposal to permit early application. Accordingly, we recommend permitting such earlier application.

Question 1 for the Board

1. Effective date for the amendments to IAS 37—Does the Board agree with our recommendation to require entities to apply the amendments for annual periods beginning on or after 1 January 2022, with earlier application permitted?

Due process steps and permission for balloting***Re-exposure***

16. As noted in paragraphs 7–8 of this paper, the Board has decided to proceed with its proposal to specify that the cost of fulfilling a contract comprises the costs that relate directly to the contract. Nonetheless, the Board will make two changes to the proposals in the Exposure Draft:
- (a) to replace the examples proposed with a clarification of the two types of costs included in the onerous contract assessment; and
 - (b) to amend paragraph 69 of IAS 37 to refer to assets that relate directly to a contract, rather than assets dedicated to a contract.
17. In the light of these changes, we considered the requirements in paragraphs 6.25–6.29 of the Due Process Handbook to assess whether the Board should re-expose the amendments to IAS 37.
18. Replacing the examples in the Exposure Draft responds to concerns and questions raised by respondents about those examples. That change is, in effect, a change in drafting—it does not represent a fundamental change to the proposals on which respondents have had no opportunity to comment. The examples set out in the Exposure Draft included both examples of (a) incremental costs (eg direct materials and labour), and (b) allocations of costs that relate directly to fulfilling the contract and other contracts (eg depreciation on equipment used to fulfil the contract). In response to feedback indicating that the examples (as articulated in the Exposure Draft) would raise more questions than answers, the Board will specify within the requirements of IAS 37 those two types of costs, which had been explained in the basis for conclusions on the Exposure Draft. We think it unlikely that re-exposure would reveal new information or feedback not already considered by the Board

because the Exposure Draft had already included the concept of incremental costs plus an allocation of other directly related costs.

19. Amending paragraph 69 of IAS 37 to refer to assets that relate directly to a contract, rather than assets dedicated to a contract, is a response to a suggestion from respondents—it was not proposed in the Exposure Draft. In our view, re-exposure is not necessary in this respect because:
 - (a) there is no change to the purpose of paragraph 69. That paragraph requires an entity to recognise any impairment loss before it recognises an onerous contract provision—in other words that paragraph explains the order in which an entity applies IFRS Standards. The change to refer to assets that relate directly to a contract would not change this purpose.
 - (b) the change is in the nature of a consequential amendment—it ensures consistency of wording in the requirements of IAS 37.
20. Accordingly, we recommend finalising the amendments to IAS 37 without re-exposure.

Intention to dissent

21. In accordance with paragraph 6.23 of Due Process Handbook, we are asking whether any Board member intends to dissent from the issuance of the amendments to IAS 37.

Confirmation of due process steps

22. We think the Board has undertaken all the due process activities identified as being required in the Due Process Handbook and, thus, is able to finalise the amendments. The appendix to this paper summarises the due process steps taken in developing the amendments to IAS 37—the applicable due process steps to date for issuing the amendments have been completed.
23. We request permission to start the balloting process if the Board is satisfied that (a) it has been provided with sufficient analysis, and (b) has undertaken appropriate consultation and due process to support issuing the amendments.

Proposed timetable for balloting and publication

24. The balloting process for the amendments to IAS 37 will commence in the near term, with the amendments planned for issuance in the second quarter of 2020.

Questions 2–4 for the Board

2. **Re-exposure**—does the Board agree with our recommendation in paragraph 20 of this paper not to re-expose the amendments to IAS 37?
3. **Dissent**—does any Board member intend to dissent from the issuance of the amendments to IAS 37?
4. **Permission to ballot**—is the Board satisfied it has complied with the applicable due process requirements and that it has undertaken sufficient consultation and analysis to begin the balloting process for the amendments to IAS 37?

Appendix—Actions taken to meet the due process requirements

Step	Required / Optional	Actions
Consideration of information gathered during consultation		
The Board posts all of the comment letters that are received in relation to the Exposure Draft on the project pages.	Required	All comment letters received by the Board (68 comment letters) have been posted on the project website here: https://www.ifrs.org/projects/work-plan/onerous-contracts-cost-of-fulfilling-a-contract/comment-letters-projects/ed-onerous-contracts-cost-of-fulfilling-a-contract/#comment-letters
Board and IFRS Interpretations Committee (Committee) meetings are held in public, with papers being available for observers. All decisions are made in public sessions.	Required	The Board discussed a summary of the comment letters in May 2019—see Agenda Paper 12 to that meeting. The Board discussed analysis of the comment letters at its meetings in September 2019 (see Agenda Paper 12 to that meeting) and October 2019 (see Agenda Papers 12B , 12C and 12D to that meeting). The project webpage has up-to-date information about all technical papers related to the project: https://www.ifrs.org/projects/work-plan/onerous-contracts-cost-of-fulfilling-a-contract/#project-history
Analysis of likely effects of the forthcoming Standard or major amendment, for example, costs or ongoing associated costs.	Required	Paragraphs BC10–BC11 of the Exposure Draft provide analysis of the likely effects of the amendments. In addition, the Board discussed the effects of the amendments on particular contracts highlighted in comment letters as part of its discussion in September 2019 (see Agenda Paper 12 to that meeting).
Round-table and outreach meetings to promote debate and hear views on proposals that are published for public comment	Optional	The amendments were discussed with the Global Preparers Forum in March 2019 and the Accounting Standards Advisory Forum in April 2019 .
Finalisation		
Due process steps are reviewed by the Board.	Required	This step will be met by this Agenda Paper.
Need for re-exposure of a Standard is considered.	Required	Paragraphs 16–19 of this paper discuss re-exposure. We recommend the Board not re-expose the amendments.

The Board sets an effective date for the Standard, considering the need for effective implementation, generally providing at least one year.	Required	Paragraphs 9–15 of this paper discuss the effective date. We recommend an effective date of 1 January 2022.
Drafting		
Drafting quality assurance steps are adequate.	Required	<p>To be completed in due course.</p> <p>The Translations, Taxonomy and Editorial teams will review the pre-ballot draft.</p> <p>We intend to send a draft of the amendments to external parties for review before finalisation. This process allows external parties to review and report back to the staff on the clarity and understandability of the draft.</p>
Publication		
Press release to announce the final Standard.	Required	To be completed in due course. A press release will be published with the amendments.
A Feedback Statement is provided which provides high level executive summaries of the Standard and explains how the Board has responded to the comments received.	Required	<p>Not considered necessary because these amendments are narrow in scope. According to paragraph 6.38 of the Due Process Handbook, a Feedback Statement is required for all new IFRS Standards and major amendments.</p> <p>The Basis for Conclusions on the amendments would explain how the Board has responded to comments received.</p>
Standard is published.	Required	The amendments will be made available on our website when published.