IFRS®

STAFF PAPER

September 2017

IFRS® Interpretations Committee Meeting

Project	**IAS 37 *Provisions, Contingent Liabilities and Contingent Assets*—Costs considered in assessing whether a contract is onerous**
Paper topic	Agenda decision to finalise

CONTACT(S) Craig Smith csmith@ifrs.org +44 (0)20 7246 6462

Introduction

1. The IFRS Interpretations Committee (Committee) received a request to clarify which costs an entity considers when assessing whether to recognise an onerous contract provision applying IAS 37. In particular, the submitter asked about the application of IAS 37 to contracts with customers previously within the scope of IAS 11 *Construction Contracts*.

2. An entity applies paragraphs 66-69 of IAS 37 in assessing whether a contract to which it applies IFRS 15 *Revenue from Contracts with Customers* is onerous. The Committee concluded that, when determining which costs to include in assessing whether such a contract is onerous, the entity does not apply the previous requirements in IAS 11 on contract costs, nor does it apply the requirements in IFRS 15 on costs that relate directly to a contract.

3. The Committee concluded that a reasonable reading of the requirements in paragraph 68 of IAS 37 on unavoidable costs of fulfilling a contract results in an entity applying one of the following two approaches:

   (a) unavoidable costs are costs an entity cannot avoid because it has the contract (for example, an entity would include an allocation of overhead costs if those costs are incurred for activities required to complete the contract).

   (b) unavoidable costs are costs an entity would not incur if it did not have the contract (often referred to as 'incremental costs').

4. The purpose of this paper is to:

   (a) analyse the comments received on the tentative agenda decision;

   (b) ask the Committee whether it agrees with our recommendation to (i) finalise the agenda decision and (ii) ask the Board to consider adding a narrow-scope research project on onerous contracts to its work plan; and

   (c) provide the Committee with a summary of respondents' suggestions regarding standard-setting.

Comment letter summary and staff analysis

5. We received 11 comment letters, reproduced in Appendix B to this paper. 10 respondents say a standard-setting project is needed to clarify the requirements in paragraph 68 of IAS 37, and thus reduce differences in amounts that entities report because they apply different reporting methods. Two respondents suggest that the Committee finalise the agenda decision to provide immediate clarity regarding the existing requirements, while the Board discusses possible standard-setting alternatives.

6. If the Committee decides to finalise the agenda decision, some respondents suggest changes to it. Other respondents disagree with the Committee's tentative conclusions on 'unavoidable costs'.

7. Respondents' concerns, together with our analysis, are presented below.

IFRS 15 and the need for standard-setting

Concern raised by respondents

8. Five respondents[1] say the main reason to add a standard-setting project is that the application of IFRS 15 (effective from 1 January 2018) will increase the population of contracts to which the onerous contracts requirements in IAS 37 apply—previously, contracts within the scope of IAS 11 were not subject to those requirements in IAS 37. As a consequence, there is an increased risk that the differing interpretations of 'unavoidable costs' may have a material effect on the amounts that entities report.

9. Paragraphs 16–21 of IAS 11 contain specific requirements defining contract costs. Respondents are concerned that, when entities apply IAS 37 to construction contracts for the first time, the lack of clarity in IAS 37 might result in entities applying different approaches to the determination of unavoidable costs.

10. As a consequence, these respondents suggest adding a standard-setting project to clarify the definition of 'unavoidable costs' in IAS 37.

Staff analysis and recommendation

11. We acknowledge that providing requirements to clarify the meaning of 'unavoidable costs' in IAS 37 would be helpful to stakeholders, including those adopting IFRS 15.

12. As noted in Agenda Paper 4 of the June 2017 Committee meeting, we think without additional requirements or explanation beyond those in paragraph 68 of IAS 37, we cannot conclude that there is only one way that stakeholders might reasonably read the requirements in that paragraph. We also acknowledge that, for some contracts, the two different ways of reasonably reading 'unavoidable costs' could result in possibly significant differences in the amounts an entity reports.

13. The question is: would it be possible to develop a narrow-scope solution for 'unavoidable costs' (or, more widely, for onerous contracts) separately from a wider

[1] Mazars, ANC, EY, ASBJ and KPMG.

project on IAS 37? It is not clear to us as yet that this is possible—initial discussions at the June 2017 Committee meeting indicated that any project would need to at least consider both unavoidable costs and economic benefits within the onerous contracts requirements, as well as the interaction of those requirements with paragraphs 63-65 of IAS 37 on future operating losses. In addition, we note that even if we had already identified a solution, it would not be possible to complete a standard-setting project before the effective date of IFRS 15—ie 1 January 2018.

14. We therefore agree with Mazars and OIC and recommend that the Committee finalise the agenda decision, subject to some clarifications discussed in paragraphs 25–27 of this paper. In our view, the Committee should not add a standard-setting project to its agenda until further research is done. Although some might question whether an agenda decision noting two possible interpretations of existing requirements is helpful, we think comments in some comment letters indicate this would be the case. In our view, the agenda decision would provide some helpful material for stakeholders on the adoption of IFRS 15.

15. We also recommend reporting the matter to the Board. In particular, if the Committee agrees, we will ask the Board to consider whether it should extract onerous contracts from the research pipeline project on IAS 37 and add a narrow-scope research project to its work plan. We also think that, if the Board decides to do so, the Committee would be well placed to support the Board in conducting the research on onerous contracts. In that case, we would bring a paper to a future Committee meeting that includes further research on onerous contracts.

Question 1 for the Committee
1. Does the Committee agree with our recommendation to: (a) finalise the agenda decision; and (b) ask the Board whether it should add a narrow-scope research project on onerous contracts to its work plan? If the Board decides to do so, we recommend that the Committee conducts this research on behalf of the Board.

Conclusions in the Tentative Agenda Decision

Concern raised by respondents

16. Some respondents say the tentative agenda decision includes interpretations of ‘unavoidable costs’ that, in their view, are inappropriate. Others suggest other interpretations that they think are appropriate.

17. Mazars says the ‘incremental costs’ interpretation is not an appropriate interpretation of unavoidable costs. This is because a dictionary definition of ‘unavoidable’ does not mean ‘ incremental’, and thus applying this interpretation of unavoidable costs would exclude costs an entity cannot avoid in fulfilling a contract.

18. Mazars also says, in its view, a ‘directly attributable costs’ interpretation (applying paragraphs 95–97 of IFRS 15) would be a reasonable reading of unavoidable costs in IAS 37. It says the phrase ‘the cost of fulfilling it’ in paragraph 68 of IAS 37 is very similar to the phrase ‘costs incurred in fulfilling a contract’ in IFRS 15. EMSA also says the interpretation of costs in IAS 37 should be consistent with IFRS 15.

19. In contrast, PWC, Deloitte and KPMG agree with the Committee’s conclusion that an entity does not apply paragraphs 95–97 of IFRS 15 when determining whether a contract is onerous; instead it applies IAS 37.

Staff analysis and recommendation

20. As noted in paragraph 31 of Agenda Paper 4 of the June 2017 Committee meeting, we think the unavoidable costs of meeting the obligations under the contract are costs an entity cannot avoid because it has the contract (the approach noted in paragraph 3(a) of this paper). The reasons for our view are similar to those outlined by Mazars.

21. Nonetheless, as discussed in paragraph 32 of Agenda Paper 4 of the June 2017 Committee meeting (and also noted by KPMG) , there are long-standing differing views on how to interpret 'unavoidable costs' in paragraph 68 of IAS 37. Without further requirements or explanation of unavoidable costs beyond those in IAS 37, we are unable to conclude that there is only one way to interpret unavoidable costs. We also understand proponents of the 'incremental costs' interpretation consider the requirements in paragraphs 63-65 of IAS 37 on future operating losses—they say this interpretation of avoidable costs aligns with the requirement in paragraph 63 not to recognise a provision for future operating losses.

22. Consequently, we recommend that the Committee retains in the final agenda decision both interpretations of 'unavoidable costs' included in the tentative agenda decision (see Appendix A to this paper).

23. In addition, as noted in paragraph 9 of Agenda Paper 4 of the June 2017 Committee meeting, paragraph BC296 of IFRS 15 explains that the Board decided not to include an onerous contract test in IFRS 15, and instead decided that entities should apply the existing requirements in IFRS Standards for onerous contracts. Consequently, we think it would be inappropriate for an entity to apply paragraphs 95–98 of IFRS 15 when assessing whether a contract is onerous. Those requirements were written for a different purpose.

24. The amount of unavoidable costs for a particular contract applying paragraph 68 of IAS 37 may be similar to what they would have been applying paragraphs 95–98 of IFRS 15. However, we continue to think an entity does not directly apply those requirements when assessing whether a contract is onerous.

Clarifying interpretations

Concern raised by respondents

25. OIC, Mazars, EY, FRC of Nigeria and ASCG suggest that if the Committee finalises the agenda decision, it should clarify the distinction between the two interpretations of unavoidable costs, perhaps by using examples.

Staff analysis and recommendation

26. We think the interpretation of unavoidable costs as 'the costs an entity cannot avoid because it has the contract' could be better explained using the phrase 'costs an entity incurs in performing activities required to complete the contract'. We have therefore suggested an amendment to the agenda decision in this respect, outlined in Appendix A to the paper.

27. In addition we recommend including additional examples to illustrate the difference between the interpretations. In particular, we recommend including as an example depreciation of assets used to complete a contract.

Question 2 for the Committee
2. Does the Committee agree with the following recommendations regarding the agenda decision (refer to Appendix A to this paper): (a) retain both interpretations of unavoidable costs included in the tentative agenda decision; (b) retain the conclusion that an entity does not apply the requirements in IFRS 15 on costs that relate directly to a contract; (c) amend the description of 'costs that an entity cannot avoid because it has the contract' to 'costs an entity incurs in performing activities required to complete the contract'; and (d) add a depreciation example to illustrate the difference between the two interpretations of unavoidable costs?

Standard-setting

28. As noted in paragraph 5, almost all respondents to the tentative agenda decision suggest adding a project on onerous contracts to the Board's or the Committee's agenda.

29. Respondents made some suggestions regarding the scope and direction of such a project. We have summarised those suggestions below. If the Board decides to add a narrow-scope research project to its agenda, we will consider these suggestions in conducting further research on onerous contracts.

Scope of a potential standard-setting project

30. Most respondents suggest developing narrow-scope amendments to IAS 37, which would clarify the meaning of 'unavoidable costs' in paragraph 68 of IAS 37. However, some respondents suggest a different scope:

    (a) Mazars says any standard-setting project should also clarify the meaning of 'economic benefits' in paragraph 68 of IAS 37.

    (b) EY says the Committee should also consider the measurement requirements for onerous contracts (paragraph 66 of IAS 37 requires an entity to measure onerous contracts as a provision).

    (c) ASBJ and KPMG suggest a standard-setting project only for contracts within the scope of IFRS 15.

Direction of a potential standard-setting project

31. In terms of defining unavoidable costs, ASBJ mentions a 'full costs' approach, similar to the approach in IAS 11. However, ASBJ says there might be little support for this approach because the number of contracts determined to be onerous would be likely to increase compared to today.

32. Another approach considered by ASBJ is to define unavoidable costs similarly to restructuring costs in paragraph 80 of IAS 37—paragraph 80 refers to 'direct expenditures arising from the restructuring, which are those that are both (a)

necessarily entailed by the restructuring; and (b) not associated with the ongoing activities of the entity'.

33. As noted in paragraph 18, Mazars and ESMA say the requirements on 'costs to fulfil a contract' in IFRS 15 should be consistent with requirements on 'unavoidable costs of fulfilling a contract' in IAS 37.

Question 3 for the Committee
3. Does the Committee have any comments on the suggestions made by respondents or other advice for the staff in conducting further research on onerous contracts?

Appendix A—Proposed wording for final agenda decision

A1. We propose the following wording for the final agenda decision (new text is underlined and deleted text is struck through).

IAS 37 *Provisions, Contingent Liabilities and Contingent Assets*—Costs considered in assessing whether a contract is onerous

The Committee received a request to clarify which costs an entity considers when assessing whether to recognise an onerous contract provision applying IAS 37. In particular, the submitter asked about the application of IAS 37 to contracts with customers previously within the scope of IAS 11 *Construction Contracts*.

As noted in paragraphs 5(g) of IAS 37 and BC296 of IFRS 15 *Revenue from Contracts with Customers*, an entity applies paragraphs 66–69 of IAS 37 in assessing whether a contract to which it applies IFRS 15 is onerous. Accordingly, the Committee concluded that, when determining which costs to include in assessing whether such a contract is onerous, the entity does not apply the previous requirements in IAS 11 on contract costs, nor does it apply the requirements in IFRS 15 on costs that relate directly to a contract.

Paragraph 68 of IAS 37 includes the definition of an onerous contract. In assessing whether a contract is onerous, an entity compares the unavoidable costs of meeting the obligations under the contract to the economic benefits expected to be received under it. The unavoidable costs under the contract are the lower of the cost of fulfilling the contract and any compensation or penalties arising from failure to fulfil the contract.

The Committee discussed two possible ways of applying the requirements in paragraph 68 of IAS 37 relating to the unavoidable costs of fulfilling the contract:

a. unavoidable costs are ~~the~~ costs ~~that~~ an entity incurs in performing activities required to complete the contract ~~cannot avoid because it has the contract~~ (for example, an entity would include (i) depreciation of assets used to complete the contract; and (ii) an allocation of overhead costs if those costs are incurred for activities required to complete the contract).

b. unavoidable costs are ~~the~~ costs ~~that~~ an entity would not incur if it did not have the contract~~,~~ ~~(~~often referred to as ‘incremental costs’ (for example, an entity would (i) include depreciation of assets used to complete the contract if the entity had purchased the assets only to fulfil that contract, and (ii) not include depreciation of assets used to complete the contract if the assets are also used by the entity for other purposes).

The Committee concluded that a reasonable reading of the requirements in paragraph 68 of IAS 37 on unavoidable costs of fulfilling a contract results in one of the two approaches outlined in this agenda decision. The Committee observed that an entity applies its reading of the requirements consistently to all applicable contracts.

The Committee also observed that paragraph 69 of IAS 37 requires an entity to recognise any impairment loss on assets dedicated to a contract before establishing a separate provision for an onerous contract.

In the light of its analysis, the Committee considered whether to add a project to its standard-setting agenda to eliminate one of the possible ways of reading the requirements. The Committee decided that amendments could not be developed for some of the requirements on onerous contracts without conducting a comprehensive review of all of those requirements. With this in mind, the Committee concluded that it would be unable to resolve the matter efficiently within the confines of existing IFRS Standards. Consequently, it ~~[~~decided~~]~~ not to add this matter to its standard-setting agenda.

Report to the Board

The Board will discuss this matter at a future Board meeting. The Committee, as well as feedback on the tentative agenda decision, suggested that the Board undertake a narrow-scope research project on onerous contracts.

Appendix B—Comment letters

Organismo Italiano di Contabilità – OIC
(The Italian Standard Setter)
Italy, 00187 Roma, Via Poli 29
Tel. 0039/06/6976681 fax 0039/06/69766830
e-mail: presidenza@fondazioneoic.it

IFRS Interpretations Committee
30 Cannon Street
London EC4M 6XH
United Kingdom
ifric@ifrs.org

24 July 2017

Re: IFRS Interpretations Committee tentative agenda decisions published in the June 2017 IFRIC Update

Dear Ms Lloyd,

We are pleased to have the opportunity to provide our comments on the IFRS Interpretations Committee ('IFRS IC') tentative agenda decisions included in the June 2017 IFRIC Update.

IAS 28—Acquisition of an associate or joint venture from an entity under common control

We think that this issue cannot be solved with non-authoritative guidance, because there is divergence in practice on how an entity should account for the acquisition of an interest in an associate or joint venture from an entity under common control. We think that these transactions are common in practice and may have a significant impact on the acquiring entity.

We strongly disagree with the IFRS IC conclusion that:
"*the requirements in IFRS Standards provide an adequate basis for an entity to account for the acquisition of an interest in an associate or joint venture from an entity under common control*."
We note that this conclusion is inconsistent with the IFRS IC Agenda Decision published in May 2013, which states that:
"…*The Interpretations Committee was specifically concerned that this lack of clarity has led to diversity in practice for the accounting of the acquisition of an interest in an associate or joint venture under common control.*
The Interpretations Committee noted that accounting for the acquisition of an interest in an associate or joint venture under common control would be better considered within the context of broader projects on accounting for business combinations under common control and the equity method of accounting…"

We also think that the existing divergence in practice is confirmed by the IFRS accounting manuals of some accounting firms. According with these manuals the following views can be considered:

- View 1: There is no scope exemption in IAS 28 for such transactions; therefore, the normal measurement rules are applicable
- View 2: An entity may apply the common control scope exclusion in IFRS 3 by analogy to the accounting for common control transactions in separate financial statements. … In our view, the common control exemption in accounting for business combinations should also apply to the transfer of investments in associates and joint ventures between investors under common control. Although IAS 28 does not include an explicit exemption for common control transactions, equity accounting follows the methodology of acquisition accounting. Therefore, we believe that it is appropriate to extend the application of the common control exemption to those transfers.
- View 3: IAS 28 is not clear. Two possible approaches:

  - Acquisition accounting: the difference between the fair value of the underlying assets and the consideration given is goodwill or a gain
  - Pooling of interests: the scope exemption for BCUCC extends to transfers of associates and JVs within an existing group

We note that the tentative agenda decision states that:
"The Committee observed that in accounting for the acquisition of the interest, the entity would assess whether the transaction includes a transaction with owners in their capacity as owners—if so, the entity determines the cost of the investment taking into account that transaction with owners."
We think that this statement may have significant unintended consequences because it might be applied by analogy to all common control transactions that are not business combinations under common control, transfer of non-financial assets (eg property plant and equipment, inventories, investment properties), transfer of financial assets, and, with reference to Separate Financial Statements, to the transfer of investments in subsidiaries. These transactions are very common in practice and some may interpret this statement as requiring to assess whether any common control transactions includes a transaction with owners in their capacity as owners (ie whether it includes a distribution or a contribution). We also question how an entity should assess whether the transaction includes a transaction with owners in their capacity as owners, given that no guidance is provided in IFRS.

Consequently, we recommend the IFRS IC to address the accounting for the acquisition of an interest in an associate or joint venture from an entity under common control issuing authoritative guidance (ie a Standard, an Interpretation or an Amendment). In doing this, we recommend to:
- carefully consider the potential consequences (especially in separate financial statements) on the accounting for other common control transactions that are not business combinations under common control;
- explain how an entity should assess whether the transaction includes a transaction with owners in their capacity as owners.

IFRS 3—Acquisition of a group of assets that does not constitute a business

We note that the tentative agenda decision states that:
"*The Committee concluded that a reasonable reading of the requirements in paragraph 2(b) of IFRS 3 on the acquisition of a group of assets that does not constitute a business results in one of the two approaches outlined in this agenda decision. The Committee observed that an entity applies its reading of the requirements consistently to all such acquisitions … The Committee has*

not obtained evidence that the outcomes of applying the two approaches outlined in this agenda decision would be expected to have a material effect on the amounts that entities report"

We do not support these conclusions. We think that the IFRS IC should clarify how an entity should apply the requirements in paragraph 2(b), because in an acquisition of a group of assets the transaction price may be different to the sum of the individual fair values of the acquired assets. This may happen, for example, because the seller in order to conclude an important transaction that involves many assets may be willing to grant a discount (that may be significant) that it would not grant if it sold only a single asset. In our view, if the discount is significant, the outcomes of the two approaches described in the tentative agenda decision may have a material effect on the financial statements of the buyer.

IAS 37—Costs considered in assessing whether a contract is onerous

We note that the tentative agenda decision states that:

"The Committee discussed two possible ways of applying the requirements in paragraph 68 of IAS 37 relating to the unavoidable costs of fulfilling the contract:

a. *unavoidable costs are the costs that an entity cannot avoid because it has the contract (for example, an entity would include an allocation of overhead costs if those costs are incurred for activities required to complete the contract).*
b. *unavoidable costs are the costs that an entity would not incur if it did not have the contract (often referred to as 'incremental costs')."*

We think that the IFRS IC should clarify the differences between the two possible ways of reading "unavoidable costs", for example specifying that an entity would not generally consider depreciation as an unavoidable cost if it applies the "incremental cost" approach (unless the entity has purchased a particular item of plant and equipment to fulfil the contract).

We also think that the IFRS IC should recommend the IASB to clarify the meaning of "unavoidable costs" in IAS 37, because the outcomes of the two approaches outlined in the tentative agenda decision may have a material effect on the entity financial statements. This should reduce the risks of difference in practice.

IAS 38—Goods acquired for promotional activities

We agree with the IFRS IC conclusions reported in this tentative agenda decision; however, we suggest clarifying in the fact pattern of the tentative agenda decision that "doctors" are not "customers" as defined by IFRS 15 *Revenue from Contracts with Customers.* This is to clarify that the guidance in IFRS 15 on identifying performance obligation does not apply to the promotional activities described in the tentative agenda decision.

Should you need any further information, please do not hesitate to contact us.

Yours sincerely,
Angelo Casò
(Chairman)

MAZARS

Mrs Sue Lloyd
IFRS Interpretations Committee
30 Cannon Street
London EC4M 6XH
United Kingdom

Paris, August 2, 2017

Tentative Agenda Decisions – IFRIC Update March 2017

Dear Sue,

MAZARS is pleased to comment on the above IFRS Interpretations Committee tentative agenda decisions published in the June 2017 IFRIC Update.

With the exception of IAS 38 (Goods acquired from promotional activities), we have strong reservations on the tentative agenda decisions proposed by the Committee.

1. The agenda decision on IFRS 3 identifies two possible ways of applying the requirements of the standards, and both of them may lead in some instances to irrelevant outcomes. Therefore, without reducing diversity in practice, the agenda decision would make some entities change their current practice for a less relevant outcome.

2. Regarding the IAS 28 issue, the Committee changed its mind since the May 2013 agenda decision, and the current tentative decision would lead to increased costs and complexity for preparers by requiring significant restatements between the financial statements of the acquirer and those of the ultimate parent.
   Moreover, the tentative agenda decision includes a statement relating to "*transactions with owners in their capacity as owners*" which could be seen as establishing a principle of identifying – and separating – an embedded equity transaction in any transaction between entities under common control that is not made on terms equivalent to those that prevail in arm's length transactions.

3. IFRS 15 has deleted IAS 11 guidance regarding the costs to consider in an onerous construction contract. We encourage the IFRS Interpretations Committee or the Board to undertake a project to provide a consistent guidance under IAS 37 on measuring provisions for onerous contracts with customers, tackling with the questions of both the costs and the expected benefits to take into account.
   In the meantime, the issue could be partially dealt with through an agenda decision, but we strongly disagree with the tentative decisions made by the Committee. We do not think that incremental costs is a reasonable reading of the requirements in paragraph 68 of IAS 37. On the contrary, we believe that the costs that relate directly to a contract as

described in IFRS 15 could be a relevant measure of the costs that the entity cannot avoid because it has the contract. We therefore do not understand the rationale for refusing that approach, which has the merit to rely on a consistency between the wording used in both IFRS 15 and IAS 37.

Our comments on the various tentative agenda decisions are detailed in the Appendices to this letter.

Should you have any questions regarding the above comments, please do not hesitate to contact Michel Barbet-Massin (+33 1 49 97 62 27) or Edouard Fossat (+33 1 49 97 65 92).

Yours faithfully

Michel Barbet-Massin

Financial Reporting Technical Support

Edouard Fossat

Financial Reporting Technical Support

MAZARS

Appendix 3

IAS 37 *Provisions, Contingent Liabilities and Contingent Assets*—Costs considered in assessing whether a contract is onerous (Agenda Paper 4)

Before IFRS 15, entities were referring to IAS 11 for onerous construction contracts and IAS 37 for onerous contracts within the scope of IAS 18. The onerous test in IAS 11 was leading to recognize an immediate expense when it was probable that total "contract costs" would exceed total contract revenue. IAS 11 was giving a precise list of which costs were to be considered as contract costs. When an entity was involved in both types of contracts (i.e. construction contracts and other contracts), different approaches may have been retained in practice when assessing the types of costs to consider in order to assess whether a contract was onerous, because of the fact that IAS 37 was unclear on this topic. When entities only had contracts falling under IAS 18 and thus IAS 37, diversity in practice also existed among them since the requirements of IAS 37 were not interpreted the same way.

IFRS 15 now addresses all types of contracts with a customer. However, IFRS 15 does not provide specific guidance to identify when a contract is or becomes onerous (especially as the guidance in IAS 11 no longer exists). An entity shall refer to IAS 37 which now applies to all contracts, including contracts previously within the scope of IAS 11. The need for clarification of IAS 37 is thus all the greater today and the stakes are hence even higher than before.

For that reason, we welcome that the Committee discussed how an entity should understand and apply the requirements under IAS 37 on onerous contracts and especially on which costs should be taken into account in order to make the assessment. However, we disagree with the tentative agenda decision which identifies two possible ways of applying such requirements, i.e. either a "full costs" approach or an "incremental costs" approach.

Firstly, we wonder why the IFRS IC deems it relevant to exclude the "directly attributable costs" approach, according to which contract costs as contemplated under IFRS 15 paragraphs 95-97 would be considered in order to assess whether a contract is onerous.
We understand that the reasoning of the IFRS IC is merely to disregard that approach because IFRS 15 does not include any guidance regarding onerous contracts and refers systematically to IAS 37. We note that the wording used in paragraph 68 of IAS 37 ("*The unavoidable costs under a contract reflect the least net cost of exiting from the contract, which is the lower of <u>the cost of fulfilling it</u> and any compensation or penalties arising from failure to fulfil it*") is very close to the wording used in paragraphs 95 to 97 of IFRS 15 ("*<u>costs incurred in fulfilling a contract</u>*"). Without any further clarification in IAS 37, we wonder how it can be said that a "directly attributable costs" approach in accordance with IFRS 15 is not possible and is not a reasonable reading of IAS 37.
We believe that this approach has the primary merit of relying on a principle of consistency of the meaning of the words used throughout IFRSs. The statement made by the Interpretations Committee that "*costs incurred in fulfilling a contract*" does not refer to the same reality depending on whether the term is contemplated within IFRS 15 or IAS 37 appears counterintuitive, even if that concept is not defined in the Glossary.

Secondly, regarding the "incremental costs" approach which is deemed reasonable by the IFRS IC, we question the link that is made between the concept of "unavoidable" costs and "incremental" costs. According to the Oxford dictionary, "unavoidable" means "not able to be avoided, prevented or ignored. Inevitable."
We believe there are some costs beyond incremental costs which are however unavoidable if the

entity has to fulfil its obligations as stated in the contract. For instance, costs relating to tools and equipment used in fulfilling the contract are unavoidable though they may not be incremental. Another example of costs that may be deemed unavoidable in order to fulfil the contract without being incremental are direct labor costs when the contract is performed by an existing workforce (i.e. which is not dependent upon the existence of the contract only).
These illustrations demonstrate that the "incremental costs" approach does not take into account costs that are "unavoidable" – in the linguistic sense of the term – when determining whether a contract is onerous. We therefore support the "full costs" approach (and we consider the IFRS 15 approach as a relevant declination of it) as a reasonable reading of the requirements in paragraph 68 of IAS 37, and would exclude the "incremental costs" approach from the possible outcomes.

In order to avoid increasing divergence in practice due to a lack of clarity of the standard, we urge the IFRS IC to refer to the Board in order to determine the best way to solve the issue on a timely basis. A standard-setting project should not only include guidance on which costs to consider in assessing whether a contract is onerous, it should also include guidance on how to assess the economic benefits expected to be received under the contract. Indeed, this is another key question that needs to be answered as soon as possible.

Having said that, and should the Committee decide nevertheless to finalize its agenda decision, we think it would be better to illustrate the differences between the "full costs" and the "incremental costs" approaches using fixed assets depreciation costs or direct labour costs, rather than the allocation of overheads, which is not in our opinion the core issue.

AUTORITE DES NORMES COMPTABLES
5, PLACE DES VINS DE FRANCE
75573 PARIS CÉDEX 12
Phone (+ 33 1) 53.44.28 53
Internet http://www.anc.gouv.fr/
Mel patrick.de-cambourg@anc.gouv.fr

Chairman

Paris, 3rd August 2017

Mrs Lloyd
IFRS Interpretations Committee
30 Cannon Street
LONDON EC4M 6XH
United Kingdom

PDC N°70

June 2017- IFRS-IC tentative decisions

Dear Mrs Lloyd,

I am writing on behalf of the Autorité des Normes Comptables (ANC) to express our views on the IFRS-IC tentative decisions published in June 2017 IFRIC Update. This letter sets out some of the most critical comments raised by interested stakeholders involved in ANC's due process.

IAS 38 – Goods acquired for promotional activities

ANC concurs with the IFRS-IC that goods acquired for promotional activities are immediately expensed.

IAS 37 – Costs considered in assessing whether a contract is onerous

ANC acknowledges and agrees that the notion of "unavoidable costs of fulfilling a contract" can be understood and applied in different ways. While we appreciate the pragmatic approach taken by the IFRS-IC at the eve of the adoption of IFRS 15, we believe that accepting two different approaches will not reduce the diversity in practice. Therefore, ANC encourages the IFRS-IC or the IASB to initiate a project to provide further guidance and to foster consistency in the application of IAS 37. This project could be undertaken as part of the IFRS 15 Post implementation review (or sooner). Among other things, such a project would explore whether further variants or approaches exist. It would also clarify whether these approaches are accounting policies or accounting estimates in light of the current IASB's project on this topic.

In the meantime ANC's view is that neither conclusion nor guidance should be introduced in the decision.

IAS 28 – Acquisition of an associate or joint venture from an entity under common control

As mentioned in the agenda paper, the request has already been discussed by the IFRS-IC in January and May 2013. It then concluded that "*it would be better to consider this matter within the context of broader projects on BCUCC and the equity method of accounting*". The scope of the BCUCC and equity method projects that is currently decided or contemplated will however not deal with that issue. Therefore, the Committee decided in March 2017 to reconsider the issue.

ANC fully supports the ambition of the Committee to address this issue but disagrees with the proposed wording for rejection and its conclusion. ANC believes that a more comprehensive analysis should be conducted before a conclusion can be made. For example, the IFRS-IC has not considered circumstances where a subgroup comprising subsidiaries and equity accounting investments are transferred within a group and whether it would be appropriate to apply the principles of predecessor accounting for the subsidiaries, and the principles of IFRS 3 for the equity accounted investments.

ANC therefore believes that the IFRS-IC should conclude consistently with its decision made in 2013 and encourage the IASB to enlarge the scope of its project on BCUCC to include this particular aspect.

ANC is also concerned by the reference to "*transactions with owners*". Those transactions cover a much wider scope than only transfers of equity accounted investments within a group, e.g. sale of goods as part of intercompany transactions. ANC suggests removing such reference which could give rise to unintended consequences.

IFRS 3/IFRS 9 – acquisition of a group of assets that does not constitute a business

ANC does not disagree with the two approaches suggested by the IFRS-IC. However, in light of the future amendment of IFRS 3 on the definition of a business, ANC believes that this issue could become far more widespread than currently observed based on the outreach conducted by the IFRS-IC. ANC therefore recommends that the IFRS-IC adds this issue to its agenda to foster consistency.

Yours sincerely,

Patrick de Cambourg

Patrick de CAMBOURG

pwc

Mr. Henry Rees
Director of Implementation and Adoption Activities
International Accounting Standards Board
30 Cannon Street
London EC4M 6XH
United Kingdom

2 August 2017

Dear Henry

Interpretations Committee Tentative Agenda Decision: IAS 37 Provisions, Contingent Liabilities and Contingent Assets – Costs considered in assessing whether a contract is onerous

We are responding to the IFRS IC's tentative agenda decision on IAS 37 Provisions, Contingent Liabilities and Contingent Assets – Costs considered in assessing whether a contract is onerous, on behalf of PricewaterhouseCoopers. Following consultation with members of the PricewaterhouseCoopers network of firms, this response summarises the views of member firms who commented on the rejection. "PricewaterhouseCoopers" refers to the network of member firms of PricewaterhouseCoopers International Limited, each of which is a separate and independent legal entity.

We agree that an entity should apply the requirements of IAS 37 when assessing whether a contract with a customer is onerous. Neither the previous requirements in IAS 11 nor the guidance in IFRS 15 on contract costs is relevant in this context.

However, we do not support the tentative agenda decision, which concludes that there are two reasonable ways to read the reference to 'unavoidable costs' in paragraph 68 of IAS 37. We understand the IFRS IC's view that IAS 37 is not completely clear. However, this agenda decision is likely to create further diversity in practice, particularly when the guidance in IAS 11 is replaced by IFRS 15. We also believe that the question satisfies the agenda criteria in paragraph 5.16 of the Due Process Handbook. We therefore encourage the IFRS IC to re-consider its decision and add this issue to its agenda with the objective of providing definitive guidance on the interpretation of IAS 37.

If you have any questions in relation to this letter, please do not hesitate to contact Henry Daubeney, PwC Head of Reporting and Chief Accountant (+44 207 804 2160).

Yours sincerely

PricewaterhouseCoopers

PricewaterhouseCoopers

PricewaterhouseCoopers International Limited, 1 Embankment Place, London, WC2N 6RH
T: +44 (0) 20 7583 5000, F: +44 (0) 20 7212 4652, www.pwc.co.uk

esma European Securities and Markets Authority

THE CHAIR

Date 18 August 2017
ESMA32-61-193

Sue Lloyd
IFRS Interpretations Committee
30 Cannon Street
London
EC4M 6XH
United Kingdom

Ref: The IFRS Interpretations Committee's June 2017 tentative agenda decisions

Dear Mrs Lloyd,

The European Securities and Markets Authority (ESMA) thanks you for the opportunity to respond to the IFRS Interpretations Committee's (IFRS IC) publication in the June 2017 IFRIC Update of the tentative agenda decisions related to the application of IFRS 3 *Business combinations* and IAS 37 *Provisions, Contingent Liabilities and Contingent Assets.* We are pleased to provide you with the following comments with the aim of improving the consistent application and enforceability of IFRSs.

<u>Acquisition of a group of assets that does not constitute a business – IFRS 3</u>

ESMA has considered the IFRS IC's tentative decision not to add to its standard-setting agenda the request to clarify how an entity accounts for the acquisition of a group of assets that does not constitute a business. ESMA notes that the IFRS IC concluded that a reasonable reading of the requirements in paragraph 2(b) of IFRS 3 on the acquisition of a group of assets that does not constitute a business results in one of the two approaches of allocation of transaction price to individual acquired assets and liabilities.

ESMA disagrees with the tentative decision not to address this issue because such decision perpetuates the diversity in practice and might even encourage inconsistent application to develop in jurisdictions where such diversity did not exist before. Furthermore, in light of the upcoming amendment to IFRS 3 on the definition of a business, ESMA is of the view that this issue could become far more widespread and material than currently observed based on the outreach conducted by the IFRS IC.

Consequently, in order to ensure consistent application of the IFRS, ESMA calls on the IFRS IC to use the opportunity to recommend to the Board to consider this issue in the currently discussed amendments of IFRS 3 on the definition of business. In the meantime, before any further guidance is provided, ESMA agrees with the IFRS IC that an entity shall apply its reading of the requirements consistently to all asset acquisitions.

<u>Costs considered in assessing whether a contract is onerous – IAS 37</u>

ESMA has considered the IFRS IC's tentative decision not to add to its standard-setting agenda the request to clarify which costs an entity considers when assessing whether to recognise an onerous contract provision applying IAS 37. ESMA notes that the IFRS IC concluded that reasonable reading of the requirements in paragraph 68 of IAS 37 on unavoidable costs of fulfilling a contract results in one of the two approaches; one defining unavoidable costs as the costs that an entity cannot avoid because it has the contract, i.e. including allocation of overhead costs; the other limiting unavoidable costs to incremental costs (referring to the costs that an entity would not incur if it did not have the contract).

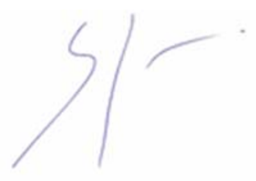
ESMA regrets that the IFRS IC concluded that it would be unable to resolve the matter efficiently within the confines of existing IFRS Standards. Based on the enforcement experience in Europe, ESMA notes that the notion of '*unavoidable costs of fulfilling a contract'* can be understood and applied in different ways. ESMA believes that accepting two different approaches will lead to increased diversity in practice. Furthermore, ESMA believes that consistency should be ensured between the interpretation of the costs to be included in the calculation of the provision under IAS 37 and the definition of the costs to fulfil a contract in paragraph 95 of IFRS 15 *Revenue from Contracts with Customers*.

Consequently, ESMA disagrees with the IFRS IC tentative agenda decision. We consider that the issue is sufficiently narrow and thus can be efficiently addressed without opening all the conceptual issues related to IAS 37. However, in light of the inability of the IFRS IC to resolve the issue efficiently, ESMA suggests the IFRS IC refers the issue to the Board to consider addressing it in a narrow-scope amendment in order to provide additional guidance and foster consistency in the application of IAS 37.

In the meantime, ESMA agrees with the IFRS IC that an entity shall apply its reading of the requirements consistently to all applicable contracts.

We would be happy to discuss these issues further with you.

Yours sincerely,



Steven Maijoor

Building a better working world

Ernst & Young Global Limited
6 More London Place
London
SE1 2DA

Tel: +44 [0]20 7980 0000
Fax: +44 [0]20 7980 0275
ey.com

International Financial Reporting Standards Interpretations Committee
30 Cannon Street
London
EC4M 6XH

18 August 2017

Dear IFRS Interpretations Committee members,

Invitation to comment – Tentative Agenda Decision: IAS 37 *Provisions, Contingent Liabilities and Contingent Assets*—Costs considered in assessing whether a contract is onerous

Ernst & Young Global Limited, the central coordinating entity of the global EY organisation, welcomes the opportunity to offer its views on the above tentative agenda decision (TAD) of the IFRS Interpretations Committee (the Committee) published in the June 2017 *IFRIC Update*.

At the June meeting, the Committee discussed the issue of "which costs an entity considers when assessing whether to recognise an onerous contract provision applying IAS 37." The question submitted addressed only the determination of the costs of fulfilling the contract, on the assumption that any compensation or penalties arising from failure to fulfil the contract will be higher than the costs of fulfilling it. Furthermore, the Committee discussed the following two possible interpretations of the unavoidable costs of fulfilling the contract when applying the requirements in paragraph 68 of IAS 37:

a) Unavoidable costs are the costs that an entity cannot avoid because it has the contract (which would include an allocation of overhead costs if those costs are incurred for activities required to complete the contract).
b) Unavoidable costs are the costs that an entity would not incur if it did not have the contract (which includes only the incremental costs of having the contract).

The Committee tentatively concluded that "a reasonable reading of the requirements in paragraph 68 of IAS 37 on unavoidable costs of fulfilling a contract results in one of the two approaches". Furthermore, the Committee concluded that amendments to IAS 37 could not be developed for these specific requirements on onerous contracts without a comprehensive review. On this basis, the Committee decided not to add this issue to its standard-setting agenda.

We would, however, encourage the Committee to reconsider its decision not to add this matter to its standard-setting agenda for the following reasons:

- Currently, the International Accounting Standards Board (IASB or Board) is not undertaking an active project on provisions which might resolve this issue. Therefore, a solution developed by the Committee would be relevant guidance for preparers, especially in relation to the application of IFRS 15 *Revenue from Contracts with Customers*.

- While the decision rejects the IAS 11 *Construction Contracts* and IFRS 15 *Revenue from Contracts with Customers* approaches, we believe that the provision of two possible interpretations of unavoidable costs will potentially increase diversity in practice as entities start to apply IFRS 15 from 1 January 2018 onwards.
- We are also concerned that the Committee's decision only relates to the issue of recognition. That is, the agenda decision relates to the criteria for recognising a provision for an onerous contract, but does not address the issue of measurement. Without such guidance, the risk of diversity created by the two approaches in the TAD in respect of recognition is now compounded by the limited guidance for measuring an onerous contract.

If the Committee decides not to reconsider its decision not to add this issue to its standard-setting agenda, we believe that the TAD should include the following aspects:

- Since the Committee rejected the IAS 11 and IFRS 15 guidance on determining the costs of a contract, and paragraphs 66-69 of IAS 37 and the TAD are silent on what costs would be regarded as those "that an entity cannot avoid because it has the contract", we believe that additional clarification and illustrative examples should be added to the agenda decision in order to clarify the meaning of 'overhead costs' when determining the unavoidable costs of fulfilling the contract; and
- A statement as to whether the concepts in the two alternatives provided for recognising an onerous contract should also be applied when measuring an onerous contract.

Should you wish to discuss the contents of this letter with us, please contact Leo van der Tas at the above address or on +44 [0]20 7951 3152.

Yours faithfully

Ernst & Young Global Limited

FINANCIAL REPORTING COUNCIL OF NIGERIA
Federal Ministry of Industry, Trade and Investment

August 17, 2017

The Chairman
International Accounting Standards Board
30, Cannon Street
London EC4M 6XH
United Kingdom

RE: INVITATION TO COMMENT ON TENTATIVE AGENDA DECISION AND COMMENT LETTERS-IAS 37 COSTS CONSIDERED IN ASSESSING WHETHER A CONTRACT IS ONEROUS

The Financial Reporting Council (FRC) of Nigeria welcomes the tentative agenda decision and comment letters - IAS 37

In view of the responses received from the constituents in Nigeria, the Council wishes to comment on the tentative agenda to IAS 37.

Tentative Agenda Decision

The Committee received a request to clarify which costs an entity considers when assessing whether to recognise an onerous contract provision applying IAS 37. In particular, the submitter asked about the application of IAS 37 to contracts with customers previously within the scope of IAS 11 Construction Contracts.

As noted in paragraphs 5(g) of IAS 37 and BC296 of IFRS 15 Revenue from Contracts with Customers, an entity applies paragraphs 66–69 of IAS 37 in assessing whether a contract to which it applies IFRS 15 is onerous. Accordingly, the Committee concluded that, when determining which costs to include in assessing whether such a contract is onerous, the entity does not apply the previous requirements in IAS 11 on contract costs, nor does it apply the requirements in IFRS 15 on costs that relate directly to a contract.

Paragraph 68 of IAS 37 includes the definition of an onerous contract. In assessing whether a contract is onerous, an entity compares the unavoidable costs of meeting the obligations under the contract to the economic benefits expected to be received under it. The unavoidable costs under the contract are the lower of the cost of fulfilling the contract and any compensation or penalties arising from failure to fulfil the contract.

LCCI Conference and Exhibition Centre, (4th Floor), Plot 10, Nurudeen Olowopopo Drive,
Central Business District, Alausa, P. O. Box 10968, Ikeja, Lagos, Nigeria.
Tel: (234) 1-7937405, 7918779, Fax: 2712153, 2712156, www.financialreportingcouncil.gov.ng

The Committee discussed two possible ways of applying the requirements in paragraph 68 of IAS 37 relating to the unavoidable costs of fulfilling the contract:

a. Unavoidable costs are the costs that an entity cannot avoid because it has the contract (for example, an entity would include an allocation of overhead costs if those costs are incurred for activities required to complete the contract).
b. Unavoidable costs are the costs that an entity would not incur if it did not have the contract (often referred to as 'incremental costs').

The Committee concluded that a reasonable reading of the requirements in paragraph 68 of IAS 37 on unavoidable costs of fulfilling a contract results in one of the two approaches outlined in this agenda decision. The Committee observed that an entity applies its reading of the requirements consistently to all applicable contracts.

The Committee also observed that paragraph 69 of IAS 37 requires an entity to recognise any impairment loss on assets dedicated to a contract before establishing a separate provision for an onerous contract.

In the light of its analysis, the Committee considered whether to add a project to its standard-setting agenda to eliminate one of the possible ways of reading the requirements. The Committee decided that amendments could not be developed for some of the requirements on onerous contracts without conducting a comprehensive review of all of those requirements. With this in mind, the Committee concluded that it would be unable to resolve the matter efficiently within the confines of existing IFRS Standards. Consequently, it [decided] not to add this matter to its standard-setting agenda.

COMMENTS

The Council agrees with the Committee that paragraph 68 of IAS 37s leaves no room for doubts on the part of preparers of financial statements on how to identify onerous contracts.

Paragraph 68 of IAS 37 states that in assessing whether a contract is onerous, an entity compares the unavoidable cost of meeting the obligations under the contract to the economic benefits expected to be received under it. The unavoidable costs under the contract are the lower of cost of fulfilling the contract and compensation or penalties arising from failure to fulfill the contract.

The Council, is however of the opinion that more clarifications, examples and guidance should be given as to what constitute "unavoidable costs".

If you require any further information or clarification do not hesitate to contact the Executive Secretary/Chief Executive Officer on (234) -7937405 or dasapokhai@financialreportingcouncil.gov.ng.

Yours sincerely,

VINCENT OKHIRIA
Assistant Director (Directorate of Accounting Standards, Public/Private)
For: Executive Secretary/CEO

Accounting Standards Board of Japan (ASBJ)
Fukoku Seimei Building 20F, 2-2, Uchisaiwaicho 2-Chome, Chiyoda-Ku Tokyo 100-0011, Japan
Phone +81-3-5510-2737 Facsimile +81-3-5510-2717 URL https://www.asb.or.jp/en/

ASBJ FASF

21 August 2017

IFRS Interpretations Committee
International Accounting Standards Board
30 Cannon Street
London EC4M 6XH
United Kingdom

Comments on the Tentative Agenda Decision Relating to IAS 37 *Provisions, Contingent Liabilities and Contingent Assets*—Costs considered in assessing whether a contract is onerous

1. The Accounting Standards Board of Japan (the "ASBJ") welcomes the opportunity to comment on the IFRS Interpretation Committee's (the "Committee") tentative agenda decision relating to IAS 37 *Provisions, Contingent Liabilities and Contingent Assets* — Costs considered in assessing whether a contract is onerous in the June 2017 IFRIC Update.

2. We agree with the view in the Committee's tentative agenda decision that the interpretation on unavoidable costs in the paragraph 68 of IAS 37 is not necessarily clear.

3. In our discussions, regarding whether to add this project to the Committee's standard-setting agenda, some were sympathetic with the Committee's tentative agenda decision stating that this project could not be solved without conducting a comprehensive review of the requirements in IAS 37 (including the various issues related to onerous contracts, for example, the definition of *onerous contracts* and *economic benefits*, and the unit of account), although providing further clarification regarding unavoidable costs may reduce diversity in practice.

4. At the same time, most were of the view that allowing two different interpretations regarding unavoidable costs would impair comparability. Assuming that the

tentative agenda decision were finalised as proposed, the following issues were raised as deep concerns:

(a) The two interpretations regarding unavoidable costs may have existed prior to the issuance of the IFRS 15, but the difference between the two interpretations may not have been as significant as that compared with the situation where IAS 37 is applied to all contracts within the scope of IFRS 15[1]. The consequences of allowing two interpretations (especially in the case where an entity chooses to adopt the incremental cost approach for contracts that were previously within the scope of IAS 11, and the magnitude of the diversity arising from different interpretations) need to be carefully considered when IAS 37 is applied to all contracts within the scope of IFRS 15 in assessing whether they are onerous.

(b) Allowing two different interpretations and providing entities a free choice regarding the costs to be included in unavoidable costs may result in significant diversity among industries and among entities that may be affected significantly.

(c) There may be confusion in practice if the amount of the costs to be included in unavoidable costs would differ depending on whether the entity utilises its own employees to do the work or chooses to outsource the work to fulfill the contract.

5. Accordingly, we do not support the Committee's decision to allow two interpretations regarding unavoidable costs.

6. In our discussions, we could not reach a consensus regarding how to avoid allowing two interpretations. Nevertheless we would like to share with you the following views for the Committee's future consideration:

(a) One approach we considered was whether to include full cost (for example, contract costs for construction contracts under IAS 11) included in unavoidable costs for all contracts within the scope of IAS 37, with the aim of achieving consistency with contracts that have been in the scope of IAS 11. However,

---

[1] Prior to the issuance of IFRS 15, the transactions that were required to be assessed whether they were onerous in accordance with IAS 37 might have been limited (for example, firm sales contracts in excess of inventory quantities held or firm purchase contracts (paragraph 31 of IAS 2) and sub-lease contracts that are probable to incur losses) when compared to all long-term service contracts such as construction contracts. Furthermore, because the difference between the two interpretations in the tentative agenda decision relates to whether to include indirect overhead costs in the unavoidable costs, the transactions that are significantly affected by the two interpretations are those that require the calculation of manufacturing costs and that have firm sales contracts, as described above.

there was little support for this approach because the number of the contracts that are determined to be onerous is likely to increase.

(b) Because this issue has arisen by expanding the contracts that are within the scope of IAS 37 as a result of the issuance of IFRS 15 (which replaces IAS 11), another approach we discussed was to limit the scope of clarification regarding this issue to transactions that are within the scope of IFRS 15. One advantage of this approach would be that most transactions that have been within the scope of IAS 37 prior to the issuance of IFRS 15 would not be affected.

(c) Yet another approach we discussed was to clarify that unavoidable costs is limited to "direct expenditure" as stated in paragraph 80 of IAS 37. One advantage of this approach would be that all contracts within the scope of IAS 37 would be treated consistently.

7. Whichever approach the Committee may choose to take, any action may change practice, depending on the nature of the entity's transactions or the entity's previous interpretation of unavoidable costs. Accordingly, instead of issuing an agenda decision, we believe this issue should be added to the standard-setting agenda and the Committee should issue a standard with appropriate effective dates and transition guidance.

8. We hope our comments are helpful for the Committee's and the IASB's consideration in the future. If you have any questions, please feel free to contact us.

Yours sincerely,

Yukio Ono
Chairman of the Accounting Standards Board of Japan

KPMG IFRG Limited
15 Canada Square
London E14 5GL
United Kingdom

Tel +44 (0) 20 7694 8871
mark.vaessen@kpmgifrg.com

Ms Sue Lloyd
International Accounting Standards Board
1st Floor
30 Cannon Street
London
EC4M 6XH

Our ref MV/288

21 August 2017

Dear Ms Lloyd

Tentative agenda decision: IAS 37 – Costs considered in assessing whether a contract is onerous

We appreciate the opportunity to comment on the IFRS Interpretations Committee's (the Committee) tentative agenda decision *IAS 37 Provisions, Contingent Liabilities and Contingent Assets – Costs considered in assessing whether a contract is onerous* (IFRIC Update June 2017). We have consulted with, and this letter represents the views of, the KPMG network.

We support the Committee clarifying which standard applies when determining the costs to include in the assessment whether a contract in the scope of IFRS 15 *Revenue from Contracts with Customers* is onerous. We agree that the entity applies the requirements in IAS 37 – i.e. it does not apply the previous requirements in IAS 11 *Construction Contracts* on contract costs, nor does it apply the requirements in IFRS 15 on costs that relate directly to a contract.

However, we disagree with the Committee's decision not to add this issue to its agenda. We believe that the Committee should reconsider the possibility of pursuing a limited scope project to clarify the meaning of the term 'unavoidable costs' in IAS 37.

There are longstanding differences of views on what costs should be considered 'unavoidable' – some hold a view that it is an 'incremental' cost concept, while others argue that it is a 'full' cost concept. We are not aware that many, if any, stakeholders regard the identification of unavoidable costs as an accounting policy choice under IAS 37, as implied by the tentative agenda decision.

There is currently diversity in practice in this area and this diversity will become more extensive on adoption of IFRS 15 because a larger population of revenue-generating contracts will be subject to IAS 37 onerous contract requirements. The tentative agenda decision, as drafted, appears to condone a foreseeable increase in diversity.

We understand that the Committee believes that it may not be able to resolve the question of 'unavoidable costs' without conducting a comprehensive review of all requirements related to onerous contracts, including for example defining 'economic benefits'. However, we note that the questions of economic benefits and costs usually arise in relation to different types of contracts. Also, a major area of current diversity in relation to economic benefits is operating lease contracts, which will fall away when IFRS 16 *Leases* becomes effective.

Therefore, we believe that the Committee should consider further the possibility of a limited scope project focused on the 'unavoidable costs' of fulfilling a loss-making contract under IFRS 15.

Please contact Mark Vaessen +44 (0)20 7694 8871 or Prabhakar Kalavacherla +1 415-963-5100 if you wish to discuss any of the issues raised in this letter.

Yours sincerely

KPMG IFRG Limited

KPMG IFRG Limited

Copy: Reinhard Dotzlaw, KPMG
Prabhakar Kalavacherla, KPMG

Deutsches Rechnungslegungs Standards Committee e.V.

Accounting Standards Committee of Germany

DRSC

ASCG • Zimmerstr. 30 • 10969 Berlin

Sue Lloyd
Chair of the IFRS Interpretations Committee
30 Cannon Street
London EC4M 6XH

United Kingdom

IFRS Technical Committee

Phone: +49 (0)30 206412-12

E-Mail: info@drsc.de

Berlin, 21. August 2017

Dear Sue,

IFRS IC's tentative agenda decisions in its June 2017 meeting

On behalf of the Accounting Standards Committee of Germany (ASCG), I am writing to comment on the tentative agenda decisions taken by the IFRS Interpretations Committee (IFRS IC) and published in the June 2017 *IFRIC Update*.

Please find our specific comments in the appendix to this letter. If you would like to discuss our views further, please do not hesitate to contact Jan-Velten Große (grosse@drsc.de) or me.

Yours sincerely,

Andreas Barckow

President

Appendix – Comments on the tentative agenda decisions

IFRS 3 – Acquisition of a group of assets that does not constitute a business

We do not agree with the tentative decision, since we are not convinced that the IFRS IC's decision to offer a choice as to in which order the requirements in IFRS 3 and IFRS 9 shall be applied is appropriate. Unless there were only insignificant differences (e.g. resulting from transaction costs only) – which we do not expect to be the case –, we believe that there is only one appropriate reading of the relevant requirements.

We believe there are (only) a few reasons why a difference between the transaction price and the sum of the individual fair values could exist and (only) a few assets to which this difference should then be allocated. Based on our understanding, there are assets where there is more uncertainty – or less reliability – as regards their fair values than for other assets. This uncertainty is reflected in the (partial) transaction price deviating from the fair value of those assets. Hence, we believe that the difference should be allocated to those assets only.

Given the specific facts and circumstances provided, we deem the fair value of financial instruments to be more reliable than the fair value of non-financial instruments (e.g. PPE). Consequently, we deem only the "second approach" an appropriate reading of the requirements – which is, firstly, to measure financial instruments at their fair value (i.e. by first applying IFRS 9) and, secondly, to allocate the "difference" to all other assets based on their relative fair values (i.e. then applying IFRS 3).

IAS 28 – Acquisition of an associate or JV from an entity under common control

We agree with the tentative decision since it appropriately clarifies existing requirements and answers the narrow issue discussed. Whilst we agree that no analogy can be drawn from IFRS 3.2(c), we nevertheless question – and suggest the IASB reconsider – why there is no comparable scope exemption in IAS 28 (i.e. why there is unlike accounting in respect of interests acquired from an entity under common control).

This said, the issue discussed underlines that more fundamental and comprehensive questions around the accounting for business combinations under common control as well as the equity method are still unanswered and deserve further and timely work.

IAS 37 – Costs considered in assessing whether a contract is onerous

We do not fully agree with the tentative decision, as it lacks clarity in detail. In particular, the wording of the decision does not clarify, nor define, which costs are comprised in applying IAS 37.68 under alternative (a) (i.e. "costs that cannot be avoided when an entity has the contract") or (b) (i.e. "incremental costs"). Hence, we believe that this decision will not reduce diversity in practice.

We consider the sum of costs comprised in applying alternative (a) being more comprehensive than the sum of costs comprised in applying alternative (b). Further, we deem the wording under alternative (a) being "too wide" and the wording under alternative (b) being "too narrow" or restrictive. We believe that the answer to the question whether any of the two alternatives are an appropriate reading of IAS 37.68 depends on how (a) and (b) are defined. The proposed wording of the decision seems to be leaving maximum room for individual interpretation as to which costs shall be comprised in the assessment and therefore does not contribute to consistent application.

IAS 38 – Goods acquired for promotional activities

We do not agree with the tentative decision. From the wording of the decision, we understand that goods shall be expensed upon ownership or right to access, if their distribution was part of "promotional activities". Further, we understand that the IFRS IC interprets BC46B as implying that, if there are promotional activities, the respective goods have no other purpose than being distributed for marketing reasons. If our understanding was correct, we would disagree with the IFRS IC's thinking.

We consider the "intention to use" the goods for marketing purpose/activities to being only a necessary condition and the actual "usability" for marketing purposes to constitute the sufficient condition leading to an entity expensing the expenditures. However, we do not agree that the mere intention to use goods for marketing purposes implies that those goods necessarily have no other purpose. Instead, we think that only if and *as far as* those goods cannot be used for other purposes, any expenditure on such goods shall be recognised as marketing expenses. Hence, we would read BC46B to rather describe a (rebuttable) presumption, not a consequence.

Deloitte Touche Tohmatsu Limited
2 New Street Square
London
EC4A 3BZ

Phone: +44 (0)20 7936 3000
Fax: +44 (0)20 7583 1198
www.deloitte.com/about

Direct phone: +44 20 7007 0884
vepoole@deloitte.co.uk

21 August 2017

Sue Lloyd
Chair
IFRS Interpretations Committee
30 Cannon Street
London
United Kingdom
EC4M 6XH

Dear Ms Lloyd

Tentative agenda decision – IAS 37 *Provisions, Contingent Liabilities and Contingent Assets*: Costs considered in assessing whether a contract is onerous

Deloitte Touche Tohmatsu Limited is pleased to respond to IFRS Interpretations Committee's publication in the June IFRIC Update of the tentative agenda decision not to take onto the Committee's agenda the request for clarification on which costs should be considered in assessing whether to recognise an onerous contract provision.

We agree with the IFRS Interpretations Committee's decision not to add this item onto its agenda and with its conclusion that the assessment of whether a contract is onerous is within the scope of IAS 37, rather than of IFRS 15 *Revenue from Contracts with Customers*.

We do not, however, think it is appropriate for the question of how the term "unavoidable costs" is interpreted to be addressed by means of an agenda decision. If this is to be clarified, it should be via a full Interpretation or amendment to IAS 37.

If you have any questions concerning our comments, please contact Veronica Poole in London at +44 (0) 20 7007 0884.

Yours sincerely

Veronica Poole
Global IFRS Leader