

INSTITUTE OF CERTIFIED PUBLIC ACCOUNTANTS OF UGANDA

COMMENTS ON ED/2018/2 ONEROUS CONTRACTS - COST OF FULFILLING A CONTRACT: PROPOSED AMENDMENTS TO IAS 37

Question 1

The Board proposes to specify in paragraph 68 of IAS 37 that the cost of fulfilling a contract comprises the costs that relate directly to the contract (rather than only the incremental costs of the contract).

The reasons for the Board's decisions are explained in paragraphs BC16-BC28. Do you agree that paragraph 68 of IAS 37 should specify that the cost of fulfilling a contract comprises the costs that relate directly to the contract? If not, why not, and what alternative do you propose?

Comments

The proposed amendments to paragraph 68 of IAS 37 *Provisions, Contingent Liabilities and Contingent Assets* seek to specify that the cost of fulfilling a contract comprises the costs that relate directly to the contract to ease valuation of the amount to be provided for rather than the incremental cost approach as it provides a more faithful representation to the Financial Statements. Identification of costs that relate directly to a contract will require application of judgment.

Although ICPAU is in support of this proposal and reasons for the Board's decisions given in paragraphs BC16-BC28, we believe some clarity may be required.

1. Whereas the Board has chosen to add a specification in IAS 37 on what costs to include when assessing whether a contract is onerous or not thereby addressing the concerns of construction contracts, the proposed solution seems to embrace all contracts within the scope of IAS 37. The ICPAU is not convinced that the consequences of the broad scope of the amendment have been fully appraised.

As such, we believe clarifications in the ED should provide considering all the contracts within the scope of IAS 37 including onerous contracts relating to all other contracts envisaged under IAS 37.

2. The Board has chosen not to specify the term 'economic benefits' of a contract. Whereas this may appear as an extension of the Board's work, the truth in practice is that the effect of giving a more elaborate description and specification of what amounts to costs in order to calm the diversity of application of costs to a contract as a way of avoiding diversity of application in practice may now turn on to the benefit side, that is, the problem of diversity in practice which would have been resolved on the cost side will now be shifted to the benefit side.
ICPAU therefore believes that clarifying the nature of the costs that are incurred to fulfill a contract cannot be addressed without clarifying the meaning of 'economic benefits'.

Question 2

The Board proposes to add paragraphs 68A-68B which would list costs that do, and do not, relate directly to a contract.

Do you have any comments on the items listed?

Are there other examples that you think the Board should consider adding to those paragraphs? If so, please provide those examples.

Comments

ICPAU notes and commends the Board on inclusion, in summary, of examples listed in paragraph 17 of the repealed IAS 11 *Construction Contracts which are* consistence with examples in other International Financial Reporting Standards particularly IFRS 15 *Revenue from Contracts with Customers*, (See paragraph 97).

However, ICPAU notes that:

- (a) The examples given only consider revenue contracts within the scope of IFRS 15 and current wording seems to be more specific to the construction industry while there are no examples provided for other contracts within the scope of the IAS 37 onerous contracts. Further guidance could be provided specifically to:
 - Leases - for examples to include lease costs that 'relate directly to a contract;'
 - Cost of wasted resources - As the examples are aligned with IFRS 15, it would be helpful to clarify whether "waste" can be included in the cost of fulfilling a contract; and
 - Costs borne due to abnormal delays in fulfilling the contract.
- (b) Further guidance may be given on allocation of directly related costs that may relate to more than one contract particularly depreciation charges, contract management and supervision costs among others.
- (c) Whereas it was a fundamental step for the ED to illustrate costs to be considered, it would be prudent to give an illustration (examples) of costs that may not be attributed to onerous contracts.

Question 3

Do you have any other comments on the proposed amendments?

- a) The Board seems not to have committed itself on the issue of whether the costs used to identify a contract as onerous are those to include in the measurement of an onerous contract provision. Paragraph BC 14 gives an implication that an entity could measure an onerous contract provision by including the same costs as it used to identify the contract as onerous which automatically does not to conclude on the matter. Without clarity, this may result into diversity in application which the Board seeks to end with amendments to IAS 37.
- b) We equally would appreciate if the Board provided clarity around what constitutes economic benefits arising from a contract in relation to onerous contracts.