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IFRS Technical Committee

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Berlin, 1. April 2019

Mr Hans Hoogervorst
Chairman of the
International Accounting Standards Board
Columbus Building
7 Westferry Circus / Canary Wharf
London E14 4HD

Dear Hans,

**IASB Exposure Draft ED/2018/2 *Onerous Contracts – Cost of Fulfilling a Contract*
(Proposed amendments to IAS 37)**

On behalf of the Accounting Standards Committee of Germany (ASCG) I am writing to comment on the Exposure Draft ED/2018/2 *Onerous Contracts – Cost of Fulfilling a Contract (Proposed amendments to IAS 37)* issued by the IASB on 13 December 2018 (herein referred to as 'ED'). We appreciate the opportunity to comment on the ED.

The IASB proposes specifying the "cost of fulfilling a contract" to comprise costs that directly relate to the contract, rather than to comprise incremental costs only. We welcome the IASB's efforts to clarify the requirements in IAS 37 *Provisions, Contingent Liabilities and Contingent Assets* and agree that the proposed clarification sets the basis for a common understanding of the term "cost of fulfilling a contract" and thereby counters diversity in accounting practice. Also, we agree that the directly related cost approach is preferable and provides a more faithful representation of the cost of fulfilling a contract than the incremental cost approach.

However, we encourage the IASB to further clarify the term "costs that relate directly to the contract" by modifying and complementing the examples proposed as well as the Basis for Conclusions.

Our detailed comments in response to the ED questions are laid out in the appendix to this letter. If you would like to discuss our comments further, please do not hesitate to contact Kristina Schwedler (schwedler@drsc.de) or me.

Yours sincerely,

Andreas Barckow

President

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Appendix – Answers to the questions in the DP

Question 1

The IASB 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 IASB'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?

We agree. Against the backdrop that IAS 11 has been withdrawn, the application of the requirements in IFRS 15 and IAS 37 allow for different interpretations as to which cost to include in estimating the cost of fulfilling a contract. The proposed clarification encourages a common understanding of the term “cost of fulfilling a contract” and, hence, improves financial reporting by preventing diversity in accounting practice.

We also agree that in assessing whether a contract is onerous, the cost of fulfilling the contract includes both incremental costs and an allocation of other costs that relate directly to contract activities. We support the reasoning provided in paragraphs BC18 to BC23 of the ED stating that the directly related cost approach provides a more faithful representation of the cost of fulfilling a contract. Further, we do not expect that the proposed clarification will lead to significant changes in the German accounting practice as the prevailing view supports an interpretation that goes beyond the incremental costs but excludes general costs.

However, in our view, the descriptions of

- the incremental cost approach (“includes only the costs an entity would avoid if it did not have the contract”) and
- the directly related cost approach (“includes all the costs an entity cannot avoid because it has the contract”)

contained in BC16 do not outline the content and difference between these two approaches sufficiently clear. Only the second sentence in BC16(b) reflects the common understanding that the costs that relate directly to the contract contain the incremental costs of the contract **and** other costs incurred on activities required to fulfil the contract. Specifically, a definition of these other costs incurred on activities required to fulfil the contract is missing, and it remains vague what these other costs might comprise. We consider the reasoning in BC26 useful (cost that can be capitalised) and encourage the IASB to expand on this explanation by describing in more detail the general principle of asset capitalisation in the context of income recognition. The examples proposed in paragraph 68A support this line of argument.

Question 2

The IASB 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.

We welcome that guidance is provided, and we find the inclusion of examples of costs that do and do not relate directly to a contract helpful. We also acknowledge that other standards (e.g. IFRS 15, IFRS 17, IAS 2, IAS 16, IAS 38 and IAS 40) contain examples of costs that are included in or excluded from the cost of an asset and that the examples now proposed are based on those in paragraphs 97-98 of IFRS 15.

However, we have difficulty in seeing a coherent principle that is being followed in paragraph 68A: They overlap and leave room for further interpretation. For instance, costs explicitly chargeable to the counterparty in paragraph 68A(d) might be

- direct costs already part of paragraph 68A(a) or (b) or
- allocated costs already part of paragraph 68A(c).

In paragraph 68B, general and administrative costs that are explicitly chargeable and that are therefore costs that relate directly to the contract are already included. Hence, we consider paragraph 68A(d) being redundant. Further, general references as covered in paragraph 68A(c) for insurance costs leave it open what kind of insurance are meant. We assume that the Board meant to include insurance policies that bear a relation to the contract and not any type of general insurance; if our understanding is correct, we suggest strengthening the wording.

In addition, the ED proposes requirements not only for construction contracts but also for all contracts in the scope of IAS 37. Therefore, we further suggest considering examples of specific types of costs that are related to purchase contracts.

Question 3

Do you have any other comments on the proposed amendments?

The transitional provisions specify that an entity shall not restate comparative information. Instead, the entity shall recognise the cumulative effect of initially applying the amendments as an adjustment to the opening balance of retained earnings (or other component of equity, as appropriate) at the date of initial application. We appreciate the IASB's objective to balance



the cost an entity would incur in first applying the amendments with the usefulness of the information provided on initial application to users of financial statements. However, since a full retrospective application is the preferred method per IAS 8, we wonder why the IASB ruled out its application. We would advocate permitting a full retrospective application as an alternative, provided the necessary information is available to the entity without the use of hindsight.