

Accounting Standards Board of Japan (ASBJ)

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Mr. Hans Hoogervorst

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Comments on the Exposure Draft *Onerous Contracts - Cost of Fulfilling a Contract* (Proposed amendments to IAS 37)

1. The Accounting Standards Board of Japan (the “ASBJ” or “we”) welcome the opportunity to provide our comments on the International Accounting Standards Board (“IASB”)’s Exposure Draft *Onerous Contracts - Cost of Fulfilling a Contract* (Proposed amendments to IAS 37) (the “ED”), issued in December 2018.
2. We support the IASB’s initiative to narrow down the multiple views regarding the costs an entity includes in determining the ‘cost of fulfilling’ a contract to assess whether a contract is onerous. However, we do not support the IASB amending only the costs the entity includes in determining the ‘cost of fulfilling’ a contract to assess whether a contract is onerous in IAS 37 *Provisions, Contingent Liabilities and Contingent Assets* (“IAS 37”) in a separate project, for the reasons stated in paragraphs 3 - 5 in this letter.
3. To assess whether a contract is onerous, an entity needs to compare the costs of fulfilling the contract and the economic benefits expected to be received under it. We believe that it is difficult to address only the cost of fulfilling a contract in a separate project, without addressing the issues related to the definition of economic benefits.

4. We believe that combining multiple contracts with a similar nature as a single unit of account and assessing whether such unit of account is onerous may result in providing useful information in certain situations. We believe that issues related to the accounting unit may affect the costs the entity should include in determining the ‘cost of fulfilling’ a contract to assess whether a contract is onerous and, from this perspective also, we think it is difficult to address only the cost of fulfilling a contract in a separate project.
5. IAS 11 *Construction Contracts* (“IAS 11”) was superseded by the issuance of IFRS 15 *Revenue from Contracts with Customers* (“IFRS 15”). Our understanding is that the IASB identified an urgent need to clarify which costs should be included in determining the costs of fulfilling a construction contract that was previously accounted for under IAS 11, by applying the requirements in IAS 37, and published the ED to address this issue. Because entities have already applied IFRS 15 and because the possibility of amending IFRS Standards twice (that is, with this project and the project to more broadly amend IAS 37) should be avoided, we believe that it is appropriate to develop accounting standards holistically, and not partially, which would also address the items described in paragraphs 3 and 4 of this letter.
6. For our other comments on the specific questions to the ED, please refer to the Appendix of this letter.
7. 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,



Atsushi Kogasaka

Chair

Accounting Standards Board of Japan

Question 1

<p>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.</p>

<p>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?</p>

1. As described in the main part of this letter, we do not support the IASB amending only the costs the entity includes in determining the ‘cost of fulfilling’ a contract to assess whether a contract is onerous in IAS 37 in a separate project. If the IASB nevertheless proceeds with standard-setting in the direction of including the costs that relate directly to the contract as the ‘cost of fulfilling’ a contract, we believe that the following matters need to be considered.

General and administrative costs

2. We believe that the purpose of the ED is to clarify the costs an entity should include in determining the ‘cost of fulfilling’ a contract to assessing whether a contract is onerous. However, the proposed paragraph 68B of the ED states that “general and administrative costs do not relate directly to a contract unless they are explicitly chargeable to the counterparty under the contract”, and an entity would be required to determine whether general and administrative costs are explicitly chargeable to the counterparty in order to determine if such costs relate directly to the contract. Accordingly, we believe the scope of the costs that relate directly to the contract is not clear.
3. We believe that, if the IASB is of the view that general and administrative costs do not relate directly to contract due to their nature that should be clearly stated in IFRS Standards. Further, we also believe that an entity should exclude general and administrative costs that are explicitly chargeable to the counterparty from the economic benefits expected to be received from the contract. In this way, the requirements would be consistent with the directly related cost approach, which would include costs incurred on activities required to fulfil the contract.

4. Agenda Paper 4, prepared for discussions at the IFRS Interpretation Committee meeting held in June 2017, includes as an example of unavoidable costs an appropriate allocation of the central human resources (HR) function costs, if the entity determines that the contract is of such magnitude that the number of employees required to fulfil the contract requires a central HR function. We are of the view that general and administrative costs qualify as costs required to fulfil the contract, if such costs relate directly to the contracts in the light of the proposed paragraphs BC16(b) and BC17 of the ED. If the IASB is of the view that certain general and administration costs qualify as costs required to fulfil the contract, we believe that entities should be required to determine whether such costs relate directly to the contract and thus it is not necessary to develop specific requirements for general and administrative costs.
5. Paragraph 95 of IFRS 15 states that the costs incurred in fulfilling a contract include the costs that relate directly to a contract, and our understanding is that the proposed paragraph 68B is based on paragraph 98(a) of IFRS 15. If the IASB were to amend the ED based on our comments in paragraphs 2 - 4 of the Appendix of this letter, we believe that IASB should amend the requirements in IFRS 15 and also reflect those amendments in the proposed paragraphs in the ED.

Costs that are explicitly chargeable to the counterparty under the contract

6. The proposed paragraph 68A(d) in the ED raises “costs explicitly chargeable to the counterparty under the contract” as an example of costs that relate directly to the contract. However, similar to the discussions related to general and administrative costs provided in paragraphs 2 - 4 of the Appendix of this letter, we believe that this requirement in the ED may obscure the scope of the costs that relate directly to the contracts.
7. Paragraph 97(d) of IFRS 15 states that the costs that relate directly to a contract include “costs that are explicitly chargeable to the customer under the contract”. Our understanding is that the example in the proposed paragraph 68(d) in the ED is based on paragraph 97(d) of IFRS 15. We believe that it would be sufficient to require entities to include the costs required to fulfil the contract, rather than to require entities to determine whether the costs are chargeable to the counterparty. Specifically, paragraph 97(d) of IFRS 15 should be deleted from paragraph 97 of IFRS 15, if IFRS15 would require entities to include the costs that relate directly to

the contract, and the example of paragraph 68A(d) of IAS 37 should also be deleted. In this way, the requirements would be consistent with the directly related cost approach.

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.

8. Refer to our answer to the question 1.

Question 3
Do you have any other comments on the proposed amendments?

Definition of economic benefits

9. The IASB acknowledged that there are issues related to the definition of ‘economic benefits’ in the context of the definition of an onerous contract in IAS 37. However, the IASB decided not to address this issue as part of the ED because doing so could cause delay. In order to assess whether a contract is onerous, it is necessary to compare the costs of fulfilling a contract against the economic benefits, and accordingly, the definition of ‘economic benefits’ should have been considered together with the issue related to the scope of the costs of fulfilling a contract. If the IASB does not address the definition of ‘economic benefits’ as part of this project but will do so in the future, there is a possibility of amending IFRS Standards twice and, accordingly, we believe that such an outcome should be avoided.

Unit of account

10. Paragraphs BC294 to BC296 of IFRS 15 states that IASB considered to include the requirements for identifying and measuring onerous performance obligations in contracts with customers (ie an “onerous test”) in IFRS 15 when developing IFRS 15

but decided to not to do so and decided to apply the onerous test in existing IFRS Standards, namely IAS 37. The onerous test in IAS 37 does not refer to the unit of account and thus the requirements for the unit of account is not necessarily clear.

11. For example, an entity may enter into a contract with a transaction price that covers only the incremental costs incurred under the contract because shared costs are covered by other contracts. In this case, if an entity is required to assess whether a contract is onerous under the directly related cost approach, an entity may need to recognise a provision when the contract is entered into, which may not necessarily faithfully represent the transaction. Instead, we believe that combining multiple contracts with a similar nature as a single unit of account and assessing whether such unit of account is onerous may result in providing useful information in certain situations. If the IASB were to amend IAS 37, we believe that it is necessary to consider the issues related to the unit of account.
12. In order to assess whether a contract is onerous, it is necessary to compare the costs of fulfilling a contract against the economic benefits. The issues related to the unit of account may affect both the costs and the benefits and, accordingly, we are of the view that it is necessary to consider the issues related to the costs of fulfilling a contract and the economic benefits altogether. If the IASB does not address the issues related to the unit of account as part of this project but will do so in the future, there is a possibility of amending IFRS Standards twice and, accordingly, we believe that such results should be avoided.

Transition requirements for first-time adopters

13. The IASB did not propose transition requirements for first-time adopters and thus proposed that those first-time adopters apply the amendments in the ED retrospectively. On the other hand, for entities already applying IFRS Standards, the IASB decided not to propose retrospective application by applying IAS 8 *Accounting Policies, Changes in Accounting Estimates and Errors* (“IAS 8”) but decided to propose that an entity apply the amendments retrospectively from the date of first applying the amendments, after considering the costs and the benefits in applying the amendments retrospectively by applying IAS 8.
14. Paragraph D34 of IFRS 1 *First-time Adoption of International Financial Reporting Standards* (“IFRS 1”) permits entities presenting their first IFRS financial statements to apply the transitional requirements in paragraph C5 of IFRS 15 to revenue.

Because the ED did not propose transitional requirements for entities presenting their first IFRS financial statements, we believe that the basis used to recognise revenue and the basis used to assess whether the contract is onerous could be different if the first-time adopter applies the transitional requirements in IFRS 15. We propose the transitional requirements described in paragraphs 15 and 16 of the Appendix of this letter.

15. For completed contracts that have variable consideration, if an entity uses the transaction price at the date the contract was completed rather than estimating the variable consideration amounts in the comparative reporting periods and applies that retrospectively in accordance with the transitional requirements in paragraph D34 of IFRS 1 and paragraph C5(b) of IFRS 15, that entity may use the transaction price at the date the contract was completed to assess, in accordance with paragraph 68 of IAS 37, whether a contract is onerous for the past reporting periods.
16. For contracts that were modified before the beginning of the earliest period presented, if an entity applies retrospectively for the past reporting periods reflecting the aggregate effects of all of the modifications that occurred before the beginning of the earliest period presented, that entity may reflect the aggregate effects of all of the modifications that occurred before the beginning of the earliest period presented to assess, in accordance with paragraph 68 of IAS 37, whether a contract is onerous for the past reporting periods.

Impairment losses on assets dedicated to a contract and provisions for onerous contracts

17. Paragraph 69 of IAS 37 states that “before a separate provision for an onerous contract is established, an entity recognises any impairment loss that has occurred on assets dedicated to a contract”. The allocation of the depreciation of fixed assets that are used for a number of contracts, if their use is necessary to fulfil the contracts, is included in the costs to assess whether a certain contract is onerous under the directly related cost approach. However, if the asset is not dedicated to a specific contract in accordance with paragraph 69 of IAS 37 because the asset is also used for other contracts, we believe the relationship between the impairment losses on an asset that is not dedicated to a specific contract and the provisions for onerous contracts is not clear.

18. We believe that paragraph 69 of IAS 37 should be amended as follows (proposed deletions are struck through and proposed additions are underlined), if the IASB decides to clarify the costs to assess whether a contract is onerous under the directly related cost approach.

Before a separate provision for an onerous contract is established, an entity recognizes any impairment loss that has occurred on assets that relate directly ~~dedicated~~ to a contract