

22 March 2019

Ms Kris Peach
Chair
Australian Accounting Standards Board
PO Box 204
Collins St West Victoria 8007
AUSTRALIA

By online submission: WWW.AASB.gov.au

Dear Kris

ED 287 Onerous Contracts – Cost of Fulfilling a Contract – Proposed amendments to AASB 137

The Australasian Council of Auditors-General (ACAG) welcomes the opportunity to comment on the Exposure Draft. The views expressed in this submission represent those of all Australian members of ACAG.

Overall, ACAG supports the proposed amendments in the Exposure Draft to clarify the costs that should be included when determining the cost of fulfilling a contract.

The attachment to this letter addresses the AASB's specific matters for comment outlined in the Exposure Draft. Also attached is ACAG's response to the International Accounting Standards Board (IASB) Exposure Draft *ED/2018/2 Onerous Contracts—Cost of Fulfilling a Contract Proposed amendments to IAS 37*.

ACAG appreciates the opportunity to comment and trusts the attached comments are useful.

Yours sincerely



Rod Whitehead
Chairman
ACAG Financial Reporting and Accounting Committee

AASB Specific Matters for comment

- 1. Whether there are any regulatory issues or other issues arising in the Australian environment that may affect the implementation of the proposals, particularly any issues relating to:**

- (a) not-for-profit entities; and**
- (b) public sector entities, including GAAP/GFS implications.**

ACAG is not aware of any regulatory or other issues arising in the Australian environment that may affect the implementation of the proposals by not-for-profit (NFP) entities and public sector entities, including GAAP/GFS implications.

- 2. Whether, overall, the proposals would result in financial statements that would be useful to users.**

ACAG believes that the proposed amendments will help preparers and auditors of financial statements measure the cost of fulfilling a contract.

ACAG believes this will result in a more consistent treatment by preparers of financial statements, thus producing more comparable and useful information for users.

- 3. Whether the proposals are in the best interests of the Australian economy.**

ACAG is not able to comment on whether these proposals are in the best interests of the Australian economy.

- 4. Unless already provided in response to specific matters for comment 1 – 3 above, the costs and benefits of the proposals relative to the current requirements, whether quantitative (financial or non-financial) or qualitative. In relation to quantitative financial costs, the AASB is particularly seeking to know the nature(s) and estimated amount(s) of any expected incremental costs, or cost savings, of the proposals relative to the existing requirements.**

ACAG is not able to comment on the costs and benefits of the proposals relative to the current requirements.

Other comments

ACAG acknowledges the IASB's reasons in BC15 for not revisiting the meaning of "economic benefits" within paragraph 68 of IAS 37 as part of this project. However, ACAG encourages the AASB to review the term "economic benefits" when reviewing the AASB 137 requirements in the future.

ACAG believes the meaning of "economic benefits" requires further consideration in the context of the NFP public sector as NFP public sector entities enter into contracts for purposes other than to receive economic benefits. Under the current framework, a contract may be considered onerous if the costs of fulfilling the contract exceed the economic benefits even if the NFP public sector entity derives other benefits.

Generally, economic benefits are quantified in terms of their contributions (directly or indirectly) to the cash flows of the entity. However, as the primary objective of NFP public sector entities is not to generate a profit, they may enter into contracts that do not result in net cash inflows to the entity. For example, they may enter into contracts to provide services to the public, further their social or strategic objectives or derive other non-financial benefits. This is supported by:

- the *Framework for the Preparation and Presentation of Financial Statements* which states:
 - “in respect of NFP entities in the public or private sector, in pursuing their objectives, goods and services are provided that have the capacity to satisfy human wants and needs. Assets provide a means for entities to achieve their objectives. Future economic benefits is synonymous with the notion of service potential, and is used in this *Framework* as a reference also to service potential. Future economic benefits can be described as the scarce capacity to provide benefits to the entities that use them, and is common to all assets irrespective of their physical or other form” (paragraph Aus49.1)
 - that “since NFP entities do not have the generation of profit as a principal objective, the provision of goods and services may not result in net cash inflows to the entities as the recipients of the goods and services may not transfer cash or other benefits to the entities in exchange” (paragraph Aus54.1)
 - “the fact that NFP entities do not charge, or do not charge fully, their beneficiaries or customers for the goods and services they provide does not deprive those outputs of utility or value, nor does it preclude the entities from benefiting from the assets used to provide the goods and services” (paragraph Aus54.2).
- *AASB 10 Consolidated Financial Statements* (paragraphs IG18-19) which broadens the scope of returns for NFP entities to encompass financial, non-financial, direct and indirect benefits, whether positive or negative, including the achievement or furtherance of the investor’s objectives.

Given the above, ACAG believes it would be beneficial for the AASB to develop guidance, in conjunction with the IASB’s project to review IAS 37, to help NFP public sector entities assess whether contracts are onerous if they do not result in net cash inflows to the entity.

22 March 2019

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ED/2018/2 Onerous Contracts – Cost of Fulfilling a Contract – Proposed amendments to IAS 137

The Australasian Council of Auditors-General (ACAG) welcomes the opportunity to comment on the Exposure Draft *Onerous Contracts – Cost of Fulfilling a Contract – Proposed amendments to IAS 37*. The views expressed in this submission represent those of all Australian members of ACAG.

Overall, ACAG supports the proposed amendments in the Exposure Draft to clarify the costs that should be included when determining the cost of fulfilling a contract.

ACAG appreciates the opportunity to comment and trusts the attached comments are useful.

Yours sincerely

A handwritten signature in black ink, appearing to read 'R Whitehead'.

Rod Whitehead
Chairman
ACAG Financial Reporting and Accounting Committee

Matters for comment

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?

ACAG agrees that paragraph 68 of IAS 37 should specify that the costs of fulfilling a contract comprises the costs that relate directly to the contract.

ACAG notes that the scope of the proposed amendments will impact the onerous assessments not only for contracts previously within the scope of IAS 11 *Construction Contracts* but for all contracts within the scope of IAS 37.

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.

ACAG supports the inclusion of paragraphs 68A–68B which clarify the type of costs that entities should consider when fulfilling a contract. However, these examples only consider revenue contracts within the scope of IFRS 15, with no examples for other contracts within the scope of the IAS 37 onerous contract test.

ACAG acknowledges that the IASB decided to focus the examples on contracts in which the entity's obligations are fulfilled by delivering non-monetary assets (such as goods and services)¹ as questions tend to arise mainly for such contracts. However, other contracts, such as purchase contracts, where the entity is required to make cash payments to the counterparty, may also be onerous. The IASB's staff working draft² (dated February 2010) under the liabilities project included the following contracts within the scope of the IAS 37 onerous test:

- fixed price purchase contracts where the benefits the entity can obtain from the products or services are expected to be less than the price it is contracted to pay for them
- loan commitments excluded from the scope of IAS 39.

In addition to the above, the working draft also included specific references to costs to terminate a contract before the end of its term which could result in the contract being onerous.

¹ <https://www.ifrs.org/-/media/feature/meetings/2018/july/iasb/ap12c-ias37.pdf>

² <http://archive.ifrs.org/Current-Projects/IASB-Projects/Liabilities/Documents/IFRSLiabilitiesWorkingDraftFeb10.pdf>

ACAG recommends the IASB include examples of costs that relate directly to the types of contracts listed above that fall outside the scope of IFRS 15 but within the scope of the IAS 37 onerous contract test.

In addition to the above, ACAG suggests the IASB review the drafting of paragraphs 68A(d) and 68B as there is a possibility it allows costs to be included that may not relate directly to the contract. Whilst the ability to charge for such costs may indicate an agreement with the counterparty that those costs relate to a contract to provide goods and services, the underlying test should be that the costs relate directly to the contract.

ACAG understands this concept was incorporated in IFRS 15 to avoid an anomaly related to contract asset receivables. If IFRS 15 only permitted costs that relate directly to the contract to be included in the contract asset receivable, and consequently exclude other costs, then the contract asset receivable would not be a true representation of the amount that can be received under the contract. The anomaly is avoided when the contract asset receivable includes costs that relate directly to the contract and any other amounts that are chargeable to the counterparty.

Question 3

Do you have any other comments on the proposed amendments?

ACAG acknowledges the IASB's reasons in BC15 for not revisiting the meaning of "economic benefits" within paragraph 68 of IAS 37 as part of this project. However, ACAG encourages the IASB review the term "economic benefits" when reviewing the IAS 37 requirements in the future.

ACAG believes the meaning of "economic benefits" requires further consideration as some entities may enter into contracts for purposes other than to receive economic benefits. For example, they may enter into contracts to further their social or strategic objectives or derive other non-financial benefits. Under the current framework, a contract may be considered onerous if the costs of fulfilling the contract exceed the economic benefits, even if the entity derives other benefits that are non-economic in nature.